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Global Commodities

A bumpy and uneven road ahead

The recovery from the COVID-19 shock is set to be uneven across regions and sectors

Industrial and precious metals are expected to be outperformers

Energy and agricultural producers face challenges due to COVID-19, climate change and trade policy



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Ten themes in focus

1) The COVID-19 pandemic has delivered a huge shock ...

Energy prices were hardest hit, while metals and agriculture did better

The COVID-19 pandemic delivered the largest global economic contraction since the 1930s in H1 2020. Energy markets were the hardest hit early on, with some oil prices forced negative in April. Oil prices have since risen, but are still well below pre-COVID-19 levels. Metals prices fell more modestly and are now almost all above their pre-COVID-19 levels. Gold prices have risen strongly on uncertainty. Agricultural prices have moved in varied directions, driven by COVID-19 and trade policy-related shocks. However, all in all, despite the larger economic shock, global commodity prices were not as hard hit as they were during the 2008/09 Global Financial Crisis.

2) ... and the recovery is set to be bumpy and uneven

The economic recovery is uneven across regions, industries and time

Most economies are recovering, although this is set to be bumpy and uneven. The recovery has been led by China, which was the first country hit by the shock. Timely indicators suggest more modest recoveries in the Western economies. South Asia, Latin America and Africa have been hard hit, and COVID-19 case numbers remain elevated in many countries in these regions. A key lesson has been that economic outcomes are highly positively correlated with health outcomes. The recoveries have also been uneven across sectors. Travel and transit remain weak, while industrial sectors and construction are recovering more strongly.

3) COVID-19 policy responses have been large and varied

Differing policy responses have added to the unevenness

Policymakers have delivered large and varied economic support packages. The major central banks have loosened monetary policy significantly and interest rates are very low. Many Western governments have supported households directly with transfer payments, and businesses with loan guarantee schemes. In contrast, China's policy support has been more directed to businesses and spending on infrastructure. To support the recovery phase, more governments may boost spending on infrastructure, particularly on 'green' projects.

4) Climate change policy and the US election in focus

The climate change agenda is gaining even more momentum

As the pandemic focuses attention on global uncertainties, climate change policy is becoming even more prominent (we discussed climate change in detail in the last edition, see [Global Commodities: COVID-19 and climate change](#), 4 March 2020). As Wai-Shin Chan, the head of HSBC's Climate Change Centre discusses below, EU policy is leading the way, with the EU Green Deal set to be the backbone of the bloc's economic recovery. And, as he also points out, the US election means that country has reached a 'fork in the road' on its climate policy path.

5) Some commodity markets face bigger challenges than others

Industrial and precious metals are winners, while oil & gas faces challenges

Across the commodities complex, we expect metals markets to continue to be winners, supported by demand from China, and supply that has been weakened by COVID-19 related disruptions. Gold prices are set to stay high on uncertainty and safe haven demand. For oil, weaker demand, due to a fall in travel and transit, as well as ample supply, is set to keep prices below pre-COVID-19 crisis levels. COVID-19 related supply constraints have lifted some agricultural prices, and as the pandemic spreads, particularly through emerging economies, more disruption is a clear risk.

Oil prices are expected to be below pre-COVID-19 levels for some time

6) Oil and gas faces COVID-19 and climate change challenges

For oil producers, there is more than the usual amount of uncertainty. COVID-19 has weakened demand for travel and transit, and it is unclear how quickly this will bounce back. The longer term demand outlook is also uncertain, as climate change policy is set to increase the use of alternative fuels. On the supply side, rapid adjustment of US shale production and OPEC constraints have helped underpin a modest lift in oil prices. Nonetheless, HSBC's Oil and Gas team expect oil prices to remain below their pre-COVID-19 levels for quite some time, with Brent forecast to average USD50 a barrel in 2021. The global gas market is heavily oversupplied, and is expected to remain so through 2021 and 2022.

Metals are well supported, with copper our most preferred

7) Metals are being driven by China and infrastructure

Demand for metals is set to remain strong as China's recovery is led by infrastructure investment and some supply is disrupted by COVID-19. HSBC's China economists expect infrastructure investment to rise by 15% y-o-y in H2 2020. Supply of some metals has also been constrained by the COVID-19 outbreak, for example, iron ore from Brazil and copper from Chile and Peru. Metals demand could also be further supported as other governments, needing to provide support for the recovery after the COVID-19 shock and able to borrow funds at low-for-longer interest rates, choose to boost spending on infrastructure.

Lithium and cobalt demand has fallen in the short run, but the medium-term looks positive

8) Battery commodities to be driven by an electric future

An immediate effect of the COVID-19 shock has been to sharply weaken production of motor vehicles, which has seen a further fall in the prices of the battery-related materials, lithium and cobalt, which were already oversupplied. However, we are more positive on the medium-term outlook for these commodities, given a strong climate change policy agenda, plans for a large number of new electric vehicle models, the re-tooling of car factories and government targets for electric vehicle market penetration. HSBC's Autos equity research team argue that electric vehicles are on the cusp of a 'tipping point' for market share.

Precious metals are expected to remain well supported

9) Gold is an outperformer and silver has played catch up

The COVID-19 shock, economic uncertainty, geopolitical risks, sharply lower interest and the rapidly rising government debt have all been positive for gold. With a bumpy and uneven economic road ahead, HSBC's Chief Precious Metals analyst, James Steel, expects gold prices to remain well supported, although he sees further price gains as hard to come by. More recently, after falling to a record low against gold, silver prices have played catch-up. The platinum group metals have been heavily affected by COVID-19, through the sharp weakening in automotive demand and mine disruptions on the supply side.

There have not been broad-based effects on agricultural prices from COVID-19

10) Agricultural prices generally steady, despite the shocks

COVID-19 has delivered a collection of shocks to a number of specific agricultural commodities in specific markets, due to both the demand and supply effects. These include effects on US beef and lumber prices, India vegetable and protein prices and global sugar prices. However, so far, there have not been widespread supply disruptions for the major food commodities, with overall agricultural commodity prices broadly steady. The effects of African swine fever on the stock of pork in mainland China have continued to see strong Chinese protein imports, particularly from the US. Implementation of Phase 1 of the US-China trade deal has continued to drive adjustments in global grain market trade.

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1. COVID-19 and the bumpy and uneven road to recovery

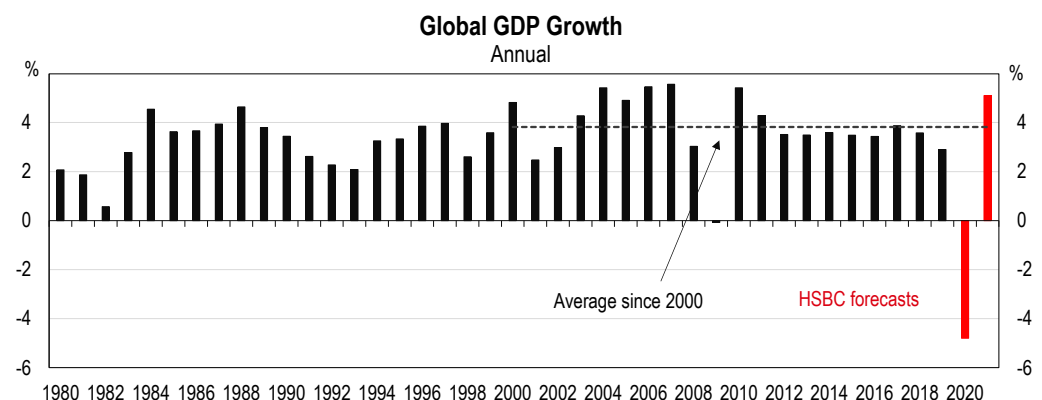
- ◆ China is leading the recovery, supporting demand for metals, while reduced travel and transit are weighing on demand for oil
- ◆ Supply-side constraints are supporting some metals prices and disrupting some agricultural markets
- ◆ Shifting policies on COVID-19, climate change and trade are all having an increasing impact across the commodities complex

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COVID-19 has delivered a huge shock

The COVID-19 pandemic has delivered the largest global economic contraction since the 1930s in H1 2020 (Chart 1.1). The shock began in China, which registered a significant 10% contraction on Q1 GDP. However, the rebound in activity in China has also been strong, with GDP rising by 11.5% in Q2, returning to above its pre-COVID-19 level (Chart 1.2). Timely indicators suggest that positive growth momentum has continued in China in Q3, although, like elsewhere, the recovery is uneven across sectors.

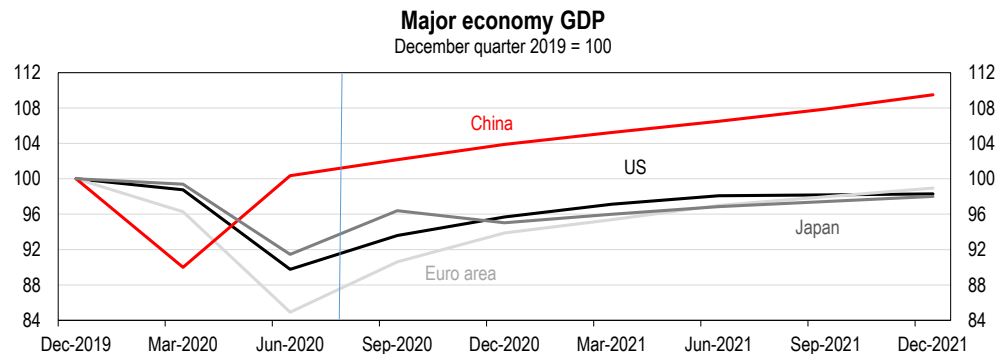
1.1. COVID-19 delivered the largest contraction in the global economy since the 1930s



COVID-19 delivered the biggest economic contraction since the 1930s

The Western economies suffered even larger economic effects of the COVID-19 shock. In the first half of 2020, US GDP contracted by 10% and Euro area GDP fell by 15%, with the largest effects concentrated in Q2. Timely indicators suggest a pick-up in economic activity in Q3 in the Western economies, although it is expected to take a considerable period before activity returns to its pre-COVID-19 levels in these regions. The recovery has also been uneven across sectors in these economies, reflecting the nature of the shock and the design of the policy responses.

1.2. The economic recovery is expected to be uneven across regions and industries



Source: IMF; HSBC estimates

The recovery is underway, but is set to be uneven across countries and sectors

North-East Asia has generally performed better than the Western economies, reflecting the fact that the virus was generally contained more rapidly than elsewhere. Protocols developed during the 2003 SARS event may have helped. The manufacturing sectors in these economies have been supported by solid demand for electronic equipment. However, as discussed below, there have also been subsequent waves of COVID-19 making the outlook uncertain.

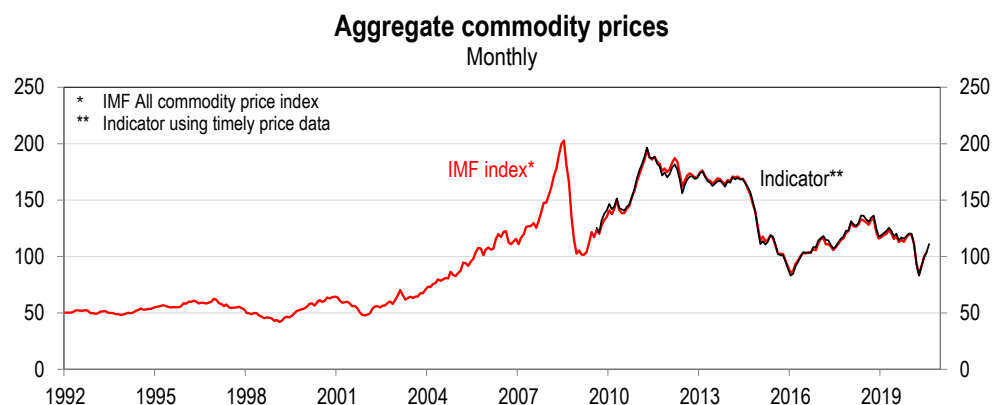
South-East Asia, Latin America and Africa have been hard hit by the virus. India has been particularly hard hit with GDP falling by 23% in the year to Q2. In South Africa, GDP fell by 17% over the same period. New COVID-19 case numbers are also still very high in India, constraining a recovery. Many of the economies in Latin America and Africa, which are large sources of supply of many commodities, face the challenges of sharply lower economic activity and still elevated COVID-19 new case numbers. Many emerging economies have considerably less scope than the developed economies to deliver significant economic policy support.

Commodity prices fell, but have bounced back solidly

Commodity prices fell by less than during the GFC and have bounced back recently

Although the COVID-19 crisis is a larger economic shock than the 2008/09 Global Financial Crisis, it has led to a smaller decline in commodity prices (Chart 1.3). At the recent depths of the COVID-19 crisis, global commodity prices had fallen 31% from their pre-COVID-19 level, to be at similar levels reached in early 2016, after the commodity price collapse of 2014-2015.

1.3. Global commodity prices fell sharply, but have since rebounded solidly



Source: IMF; HSBC estimates

By comparison, the aggregate index declined by 50% between July 2008 and February 2009. Commodity prices have since rebounded, although this has been uneven across commodities, as we discuss further below.

COVID-19 and the risk of more waves

The full effects of the COVID-19 shock are yet to play out ...

However, the full effects of the shock are far from over. One element of this is that new cases of the virus are still elevated in some locations. Another challenge is that the COVID-19 shock may deliver permanent structural change, or accelerate structural adjustments that were already underway.

In the first instance, managing the virus remains a key issue. As the COVID-19 crisis has played out, the evidence has accumulated showing that better health outcomes are highly positively correlated with better economic outcomes, irrespective of 'social distancing' policy choices. Some countries have had more success in containing the COVID-19 virus than others.

... because case numbers are still elevated in many locations ...

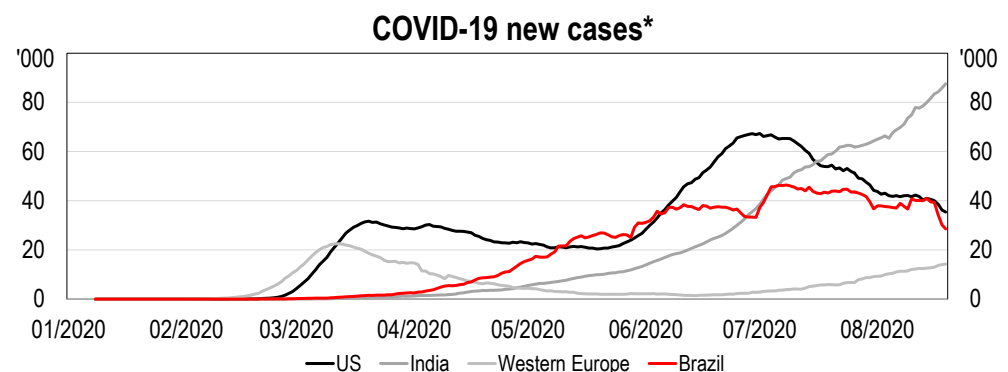
As a result, tracking the new cases numbers has become a critical driver of assessing the risks to the economic outlook. Low case numbers in China are clearly consistent with the stronger economic recovery that is underway in that economy and the positive timely indicators. By comparison, still elevated case numbers in the US are a risk to the strength of the economic recovery, as is the recent upswing in case numbers in Western Europe (Charts 1.4 and 1.5).

For commodities markets, these key regions are clearly the largest sources of demand, although with a large amount of variation (for example, China dominated demand for metals, while the Western economies are the largest source of demand for oil).

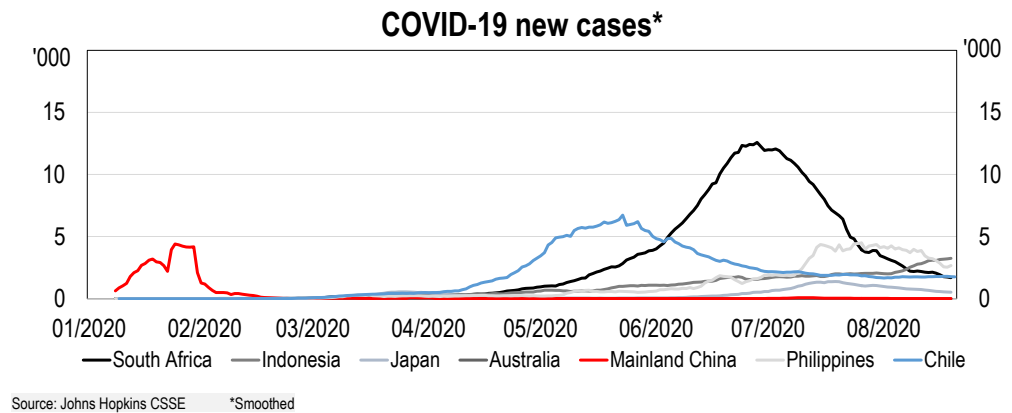
... and because the pandemic may deliver some permanent structural changes

For other regions, such as Latin America and Africa, high case numbers are affecting commodity supply. For many emerging economies, where agricultural production is a larger share of their economies the disruption from COVID-19 is affected supply chains, agricultural commodity prices and creates increased risk of rising poverty.

1.4. Varying COVID-19 numbers across regions ...



1.5. ... are driving uneven and bumpy recoveries



A bumpy and uneven road to recovery

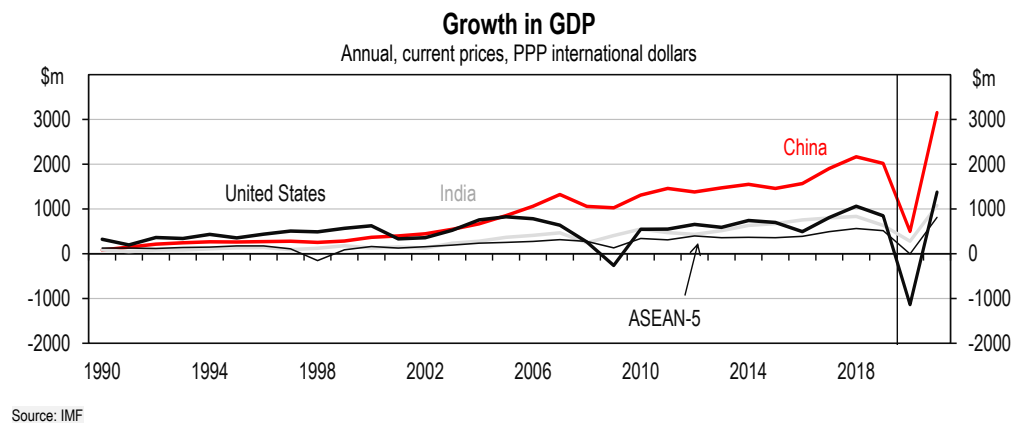
In sum, these developments mean that there is considerable uncertainty about the outlook. It also means that the road to recovery is likely to be a bumpy and uneven one.

The recovery is uneven across regions, with China leading the way

One element of this unevenness is that China looks set to have a stronger economic recovery than elsewhere. HSBC's China economists recently revised up their forecast for Chinese growth, with GDP now expected to rise by 2.4% in 2020 (previously 1.7%) and then grow by 7.5% in 2021 (see [Greater China Economics: Turning more positive on mainland China 2020 growth](#), 24 August 2020).

Estimates from the IMF show an expectation that the role of mainland China in driving global growth is set to become even larger. Our preferred way demonstrating this is to compare the change in GDP for each year in dollar values (at PPP prices) across a range of major economies (Chart 1.6). On the IMF estimates this shows that China has been the largest contributor to global GDP growth since 2006. The projections suggest that in 2021 China could contribute around one-third of global growth and more than the combination of the US and EU in that year.

1.6. China's role in driving global growth is expected to become larger



There is also considerable unevenness across sectors

Another element of the unevenness of the expected recovery is across sectors. Part of this reflects the nature of the shock and the health policy response. Social distancing measures clearly seek to reduce social activity, weighing on those forms of economic activity. The COVID-19 shock has

seen a sharp increase in digital activity, rather than in-person activities, such as work from home, on-line retail sales, and conference calls rather than business travel. All of these effects are weighing on travel and transit, in particular.

Differing policy response are also driving different recoveries across regions

Varying economic policy responses across countries are also driving unevenness in the recovery. In China, the stimulus measures have mostly been targeted to infrastructure and measures to support businesses. In the Western economies, much more of the stimulus has been targeted at providing direct support for household income, including through boosted unemployment benefits and use of wage subsidy schemes.

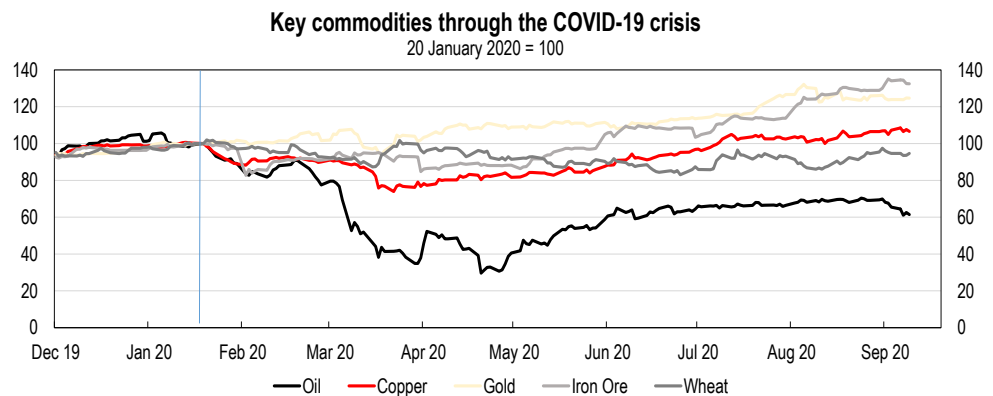
Commodity market performance has been varied

The varied effect of the shock on different countries, as well as the different policy responses have delivered uneven economic outcomes across regions and sectors, with varying implications for the different commodity markets.

Metals have fared a lot better than oil markets

Amongst the hardest hit commodities was the oil market, which has been heavily affected by both demand and supply side developments (Chart 1.7). Similar to the 2014-2015 experience this, once again, reflected a large boost to oil supply from OPEC, although in this case it was also driven by sharply lower demand due to COVID-19. Industrial metals prices have held up better and, in some cases, are now back at, or above, the pre-COVID-19 levels. Gold prices have risen through the episode, driven by safe haven demand.

1.7. Metals have fared a lot better than oil prices following the COVID-19 shock



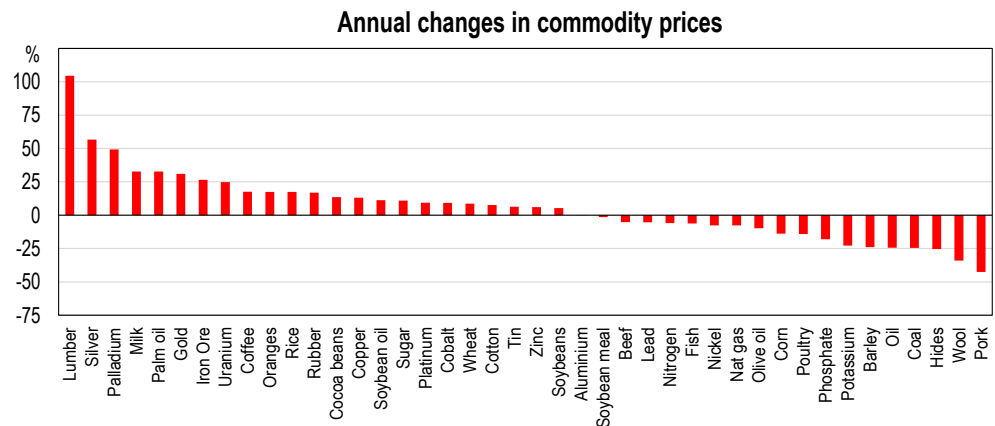
Source: Bloomberg

There has been considerable variation across the 42 commodities we track

Looking in more detail across the full range of 42 commodities that we track (which are in the IMF global commodity price index), reveals even more variation (Chart 1.8).

The strongest performer over the past year has been the US price of lumber. This price rise has occurred in recent months and reflects a combination of strong demand, as there has been an increased in Do-It-Yourself home renovation activity, and limited anticipation of this boost to demand by sawmills. Another clear pattern is that the precious metals that we track are all amongst the top price performers over the past year. Most of the metals prices are higher over the past year.

1.8. There has been considerable variation across different commodity prices



Source: Bloomberg

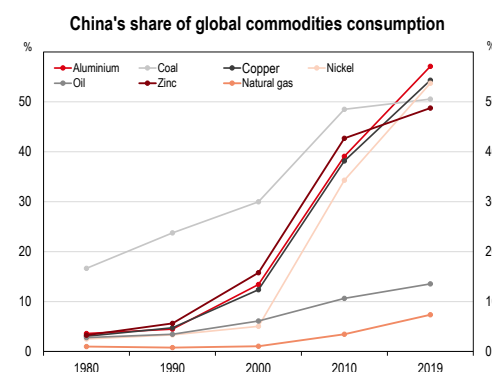
At the other end of the spectrum, pork prices have fallen, as the effect of African swine fever on global supply has waned. The price of wool has fallen as a result of much weaker demand for fashion goods as a result of the COVID-19 shock. Thermal coal prices have fallen, as the COVID-19 pandemic has weakened demand and there has been some substitution towards liquefied natural gas, given significant new capacity to produce gas has come on to the global market.

Metals demand supported, particularly by mainland China ...

The solid economic recovery in mainland China is supporting a pick-up in demand for metals. This partly reflects that mainland China is the world's largest source of demand for metals and that the recovery in China is being led by infrastructure investment, which tends to be metals-intensive. Mainland China consumes over half of the world's production of aluminium, coal, copper, and nickel and almost half the world's zinc (Chart 1.9). By comparison, China consumes only around 15% of the world's oil production and less than 10% of its gas.

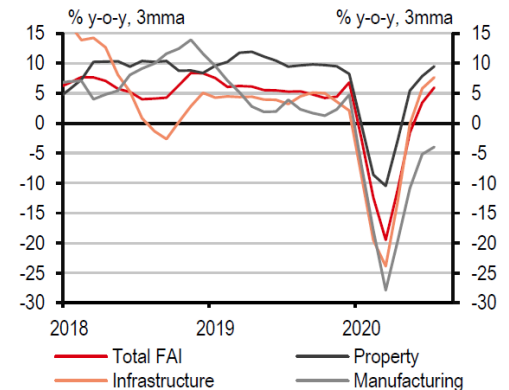
A substantial boost to China's infrastructure investment is supporting metals demand

1.9. China dominates demand for metals but not for energy



Source: World Bank

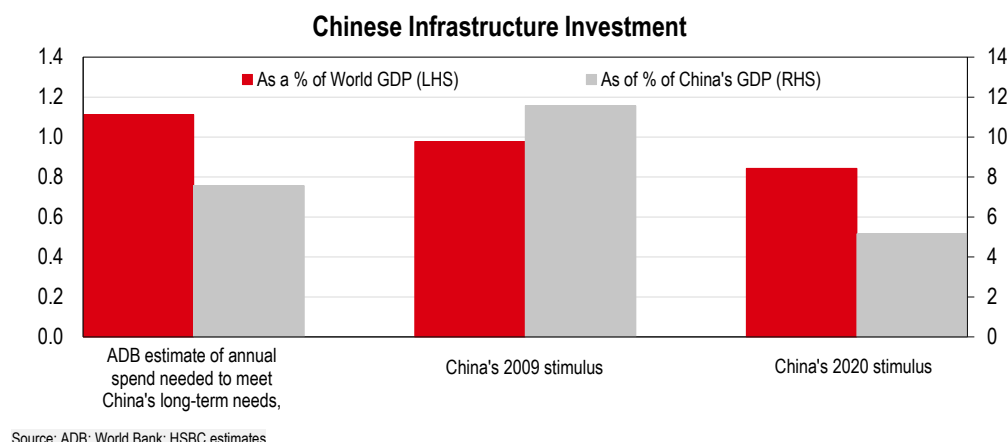
1.10. Infrastructure investment is leading the investment recovery in China



Source: CEIC; HSBC

To support growth in the face of the COVID-19 shock, China has already ramped up its infrastructure spending (Chart 1.10). So far, government announcements on bond issuance (most of which is intended to support local government infrastructure investment) and centralised infrastructure spending amount to over RMB5trn, or around 5% of GDP. In nominal terms, that amount of spending would be larger than the 'shock and awe' stimulus delivered in 2009. However, in relation to the (now much larger) Chinese and global economies, it is not as big as the 2009 stimulus, although it is still a sizable share of global GDP (Chart 1.11).

1.11. China's infrastructure spend is smaller this time, but still significant



The boost to infrastructure spending is less than was delivered after the 2008/09 GFC, but is still large

From a medium-term perspective, there are always questions about whether this boost could lead to over-investment. Somewhat allaying this concern is the fact that the building is of a different kind to that delivered in the wake of the GFC. As per HSBC's China economists' estimate, around 23% of the announced spend is for upgrading urban infrastructure (waste treatment, parking), 16% for industrial parks, 8% for environmental protection, and 7% for provision of social services (hospitals, schools, etc) (see [China Inside Out: An uneven recovery](#), 30 June 2020).

This is broadly in line with that recommended by the Asia Development Bank, where the largest part of the estimated needed spending on infrastructure is on capacity to produce electricity, followed by transportation, telecommunications and water and sanitation (see [Commodities Digest: China's Belt and Road Initiative](#), 14 June 2017).

Other governments may boost infrastructure spending to support their recoveries ...

To support the recovery phase, more governments may boost spending on infrastructure, which could provide even more support for metals demand. In particular, the rising focus on the climate change challenge from governments, businesses and the public could see much of this spending aimed at environmental projects and a shift in transport from carbon-based energy production to renewables.

... it may have a 'green' focus

We discussed the climate issue and its implications for commodity market in detail in our last Global Commodities update (see [Global Commodities: COVID-19 and climate change](#), 4 March 2020). Wai-Shin Chan, the head of HSBC's Climate Change Centre, provides an update on key policy developments below.

... and COVID-19 is constraining supply of some metals

COVID-19 has constrained supply of some metals, particularly from Latin America

In addition to a pick-up in demand, a number of metals prices have been supported by concerns about supply disruptions caused by COVID-19. This has included copper, iron ore and zinc as Latin America, which is a large producer of these metals and has been hard hit by the virus. Supply of nickel from the Philippines and gold, platinum and palladium from South Africa, have also been affected (for more details see Chapters 3 and 4 below).

- ◆ For copper, London Metal Exchange inventories have fallen to their lowest levels since 2006, with stocks falling by half in the just the past three months, due to strong demand and constrained supply from Chile. Across the metals space, HSBC's Metals team is most positive about the outlook for copper prices.

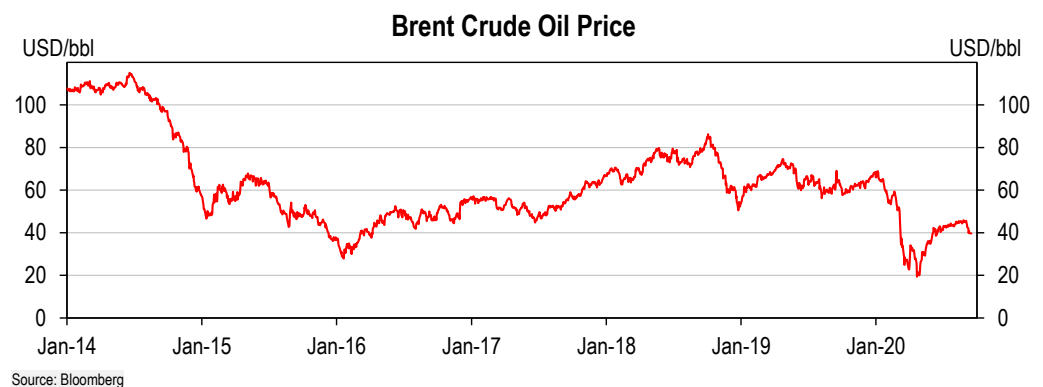
- ◆ Iron ore supplies were impacted in the first half of the year by unfavourable weather in Australia and Brazil in Q1 and then the impact of COVID-19 and related lockdowns on Brazilian supply.
- ◆ Nickel prices have been supported by some supply disruption in the Philippines, with year-to-date, nickel ore exports from Philippines to China down 20% y-o-y.
- ◆ The combination of low zinc prices and COVID-19 induced containment measures in China, Peru, Mexico and Bolivia has weighed on zinc supply by around 1.3mt of contained zinc (c10% of demand).
- ◆ Gold supply was also impacted by the pandemic, falling 6% to 2,192t as both mine production and recycling were affected by lockdown restrictions.
- ◆ For platinum, the pandemic is curtailing both primary and secondary platinum production. Mine supply is down this year due to temporary – but severe – shutdowns at mining operations. The latest data shows South African June PGM production declined 43% y-o-y.
- ◆ The palladium market is in a long-running structural supply/demand deficit, and COVID-19 has further curbed mine output.

Oil outlook is highly uncertain

Oil prices fell to their lowest level in almost 20 years in April as a result of the COVID-19 shock and developments on the supply-side (Chart 1.12). COVID-19 sharply lowered demand for oil, and, around the same time, in early March, OPEC+ were unable to agree on measures to constrain supply. The Brent oil price fell to a low point of USD19 a barrel in April. Some oil markets had extraordinary developments, with, for example, specific storage capacity issues around Cushing, Oklahoma, driving West Texas Intermediate futures to trade negative for the first time ever.

Oil prices fell sharply, then bounced back, but are weakening again

1.12. Oil prices fell sharply and have rebounded, but remain below pre-COVID-19 levels

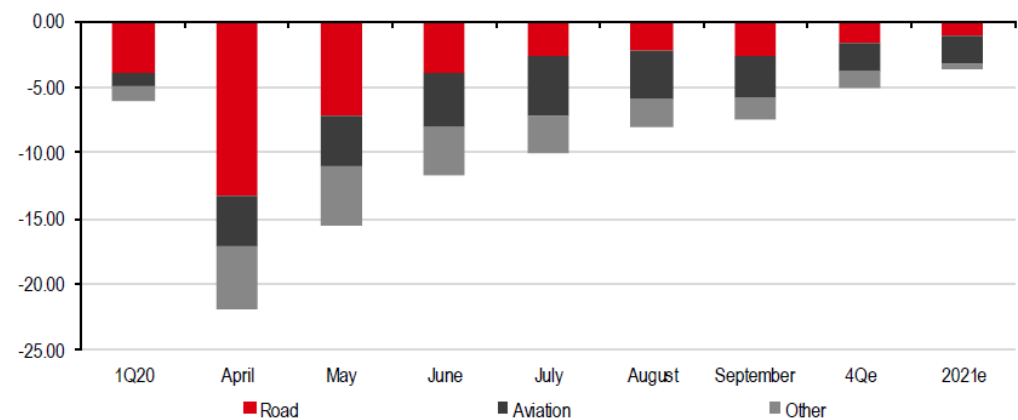


Through May and June oil prices rose solidly. This partly reflected a modest rise in demand, but also a sharp fall in supply, as OPEC+ agreed in mid-April to reduce its supply, and US shale producers significantly pulled back on oil supply. However, more recently, oil prices have fallen back a bit, mostly reflecting some moderation in demand growth, particularly for jet fuel.

There is an unusually large degree of uncertainty about the outlook for oil demand

There is currently more than the usual degree of uncertainty regarding the outlook for oil markets, both in the short- and longer terms. In the short run, much of this uncertainty reflects the extent to which travel and transit should be expected to bounce back, and what that might mean for oil demand (Chart 1.13).

1.13. Global oil demand destruction – demand versus FY2019, millions of barrels a day



Source: IEA; Rystad Energy; HSBC estimates

The re-opening of many Western economies after lockdowns earlier in the year has seen a pick-up in demand for oil, after its record decline in April, but demand is still well below the pre-COVID-19 levels. Global commercial flights, which fell to 30,000 in April, have risen to 66,000 in July, but are still well below the 100,000 a month pre-COVID-19.

The outlook for travel and transit matters a lot and is highly uncertain

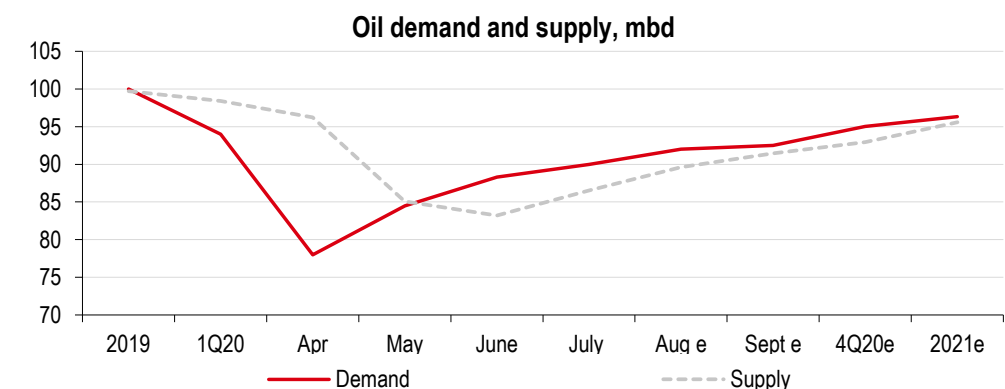
Re-opening of some economies over the Northern hemisphere summer has also seen a pick-up in the virus numbers and subsequent weakening in demand for travel, which has weighed on demand for fuel in recent weeks. It seems likely that demand will remain below pre-COVID-19 levels for some time yet. The stronger bounce-back in China's growth than elsewhere is positive, but less so for oil than it is for metals demand, as the Western economies still dominate demand for oil.

In short, the recent demand data suggest that the recovery from here will be slow, which could be a headwind for crude.

Oil supply is expected to be constrained by OPEC+ in particular

However, as the team describes in demand in Chapter 2 below, HSBC's central case is that a fall in crude oil supply, both voluntary and involuntary, has brought the market back into balance and is likely to keep it tight in 2021 (Chart 1.14). The team expects OPEC+ to err on the side of caution, and only increase supply significantly if it is convinced this would not result in a return to oversupply. Nonetheless, the team expects oil prices to remain below their pre-COVID-19 levels for quite some time, with Brent forecast to average USD50 a barrel in 2021.

1.14. Demand for oil is well below previous levels, but supply has corrected too



Source: IEA; HSBC estimates

The longer term demand outlook is also uncertain, due to the possible structural impacts of the COVID-19 crisis, as well as the climate change policy outlook. These issues are discussed further by HSBC's oil and gas team in Chapter 2.

Climate change policy is a key uncertainty for longer term oil demand

In particular, in July, EU members formally approved what has been billed as the world's largest climate stimulus package aimed at accelerating action to reduce emissions across the region. On the other hand, the US election on 3 November means that climate policy and likely implications for oil markets are at a 'fork in the road' in that country, as Wai-Shin Chan discusses further below.

COVID-19 has had a limited effect on agricultural prices ... so far

For agricultural markets, the COVID-19 pandemic has added a further shock to a long list of others that have occurred in recent years, including African swine fever, rising global trade tensions, and climate change, amongst other more typical weather variability.

Agricultural product markets have endured many shocks, including COVID-19 ...

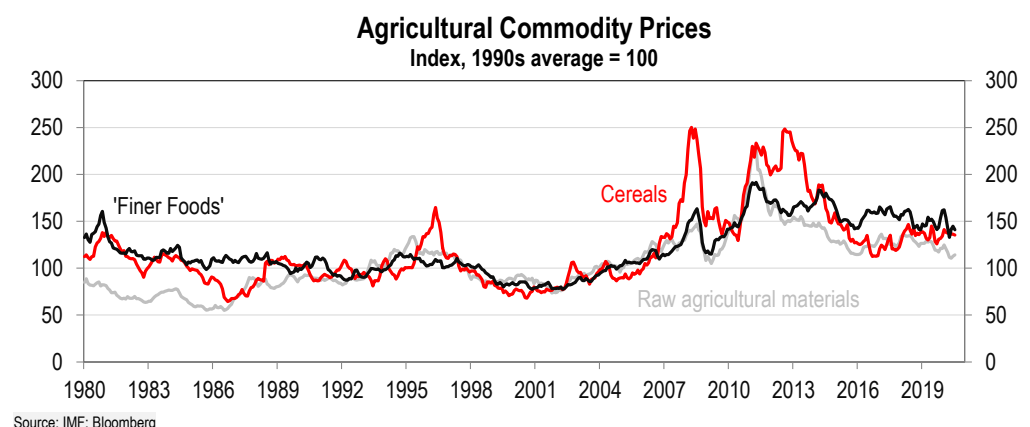
At the outset of the COVID-19 crisis, in particular, there was concern from some observers that the virus would lead to significant disruption to supply chains of agricultural products, which could have an adverse impact on food supply and poverty rates, and drive up food prices.

However, six months into the crisis, aside from localised, commodity-and location-specific effects (some discussed further in Chapter 6 below) the overall picture is of fairly limited disruptions from COVID-19, leaving overall agricultural commodity prices broadly steady (Chart 1.15).

... but overall prices have remained comparatively stable

Indeed, agricultural commodity prices have been far more stable than they were during the 2008/09 Global Financial Crisis, or in the immediately subsequent years. This seems to reflect a number of factors including that unlike the GFC episode, prior to the COVID-19 event there was little evidence of agricultural commodity shortage (with the key exception of pork, which was heavily affected by African swine fever). Trade finance also appears to have been less heavily affected by COVID-19 than it was by the GFC.

1.15. Agricultural prices have been steadier through the COVID-19 crisis than the GFC



There have been some localised effects of COVID-19 for some agricultural products

There have, however, been some localised and commodity-specific effects (which we discuss further in Chapter 6), including:

- ◆ US beef prices rose sharply in May as COVID-19 disrupted abattoir operations, but fell back to pre-COVID-19 levels as meat processing operations returned to normal rates.

- ◆ US lumber prices have increased strongly in July and August as a result of demand for Do-It-Yourself home renovation activity (perhaps a result of more work from home, furloughed worker schemes and high unemployment), and limited anticipation of this boost to demand by sawmills.
- ◆ Sugar prices fell sharply in response to COVID-19, and have subsequently bounced back, due to sharply lower and then rising demand for ethanol (which is highly correlated with oil demand). However, there are potential harvest delays in India due to a migrant labour shortage.
- ◆ In India, the prices of vegetables and some proteins have risen as supply has been disrupted.

African swine fever and the US-China Phase 1 deal re-shape trade

African swine fever's effect on China's stock of pork has been reshaping global meat trade ...

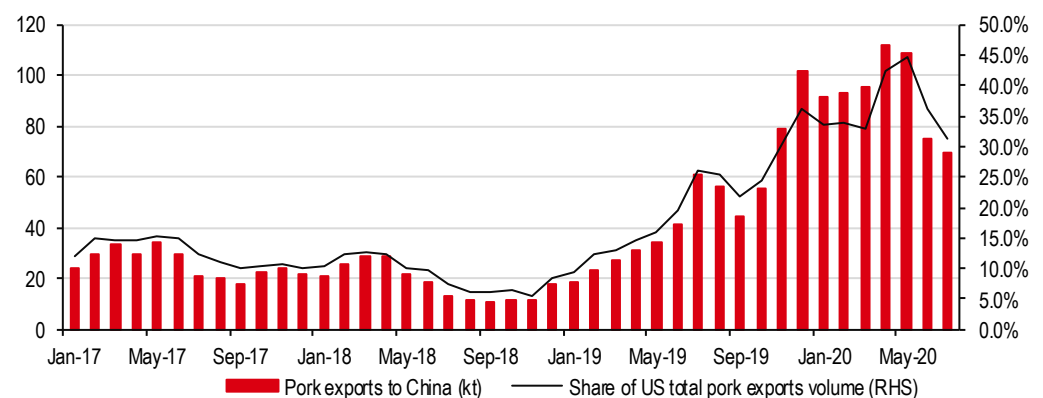
Trade in agricultural products has also been heavily affected by rising trade tensions and policy changes, particularly those between the US and China. When trade tensions between the US and China were escalating through 2018 and 2019, China imposed significant retaliatory tariffs on US goods exports. This saw a sharp shift in China's imports of soft commodities away from US suppliers.

However, the signing of Phase 1 of the US-China trade deal in January 2020 included a commitment from China to significantly boost its imports of US products, particularly soybeans and pork. China committed to purchase an additional USD12.5 billion worth of US agricultural products in the first year of the agreement and a further USD19.5 billion worth in the second year. US soybean sales to China have risen sharply in recent months to be well above seasonal peaks reached previous years and some weather-related concerns about US soybean supply have recently lifted US soybean futures prices to multi-year highs.

... as has Phase 1 of the US-China trade deal

This agreement has also come at a time when China has been boosting its protein imports to replace lost pork as a result of African swine fever. Although there has been some pick-up in mainland China's sow herd size since its trough in late 2019, the herd size is still only 82% of its pre-African swine fever level. Mainland China, which is usually self-sufficient in pork supply, has ramped up its meat imports and particularly its pork imports from the US (Chart 1.16). For more details on agricultural commodities see Chapter 6 below.

1.16. US pork exports to China are high – despite a strong USD, they are up c172% YTD y-o-y



Source: USMEF

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Europe's 'green deal' is a key
 element of the global climate
 change policy shift

Climate change policy agenda gains momentum in Europe ...

As the pandemic focuses attention on global uncertainties, it has made the **climate change policy agenda even more prominent** (we discussed climate issues in detail in our last update; see [Global Commodities: COVID-19 and climate change](#), 4 March 2020).

In particular, the EU Commission launched a consultation in July on a carbon border tax as the EU Council seeks its introduction in 2023.

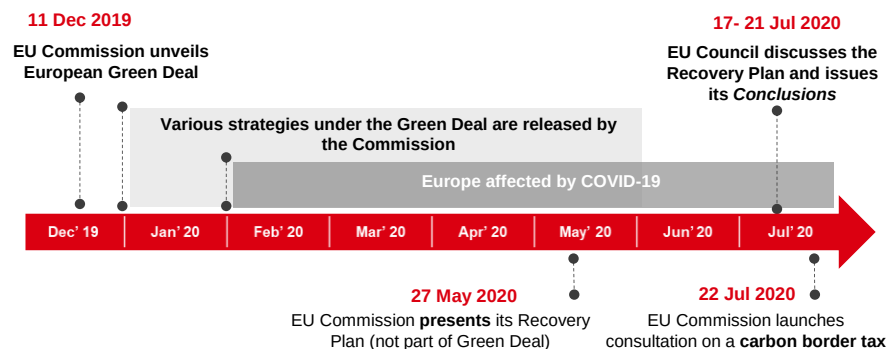
Europe's climate path is becoming clearer

Europe has continued in its quest to become a global climate leader through its EU Green Deal. The focus over 2020 has shifted towards dealing with the pandemic as well as the resulting economic uncertainty, however this has not thrown the climate cause off track.

Europe's Green Deal is updated in light of COVID-19

Done deal? The EU Green Deal was unveiled by the Commission *before the COVID-19 pandemic*. Although there has been some delay in the timeline, the bloc has been actively seeking to incorporate a suitable COVID-19 response in Green Deal strategies and funding (Figure 1.17). Member states have been under pressure to conform with the vision of a sustainable economic recovery. In our view, businesses and investors should plan for longer term (climate or coronavirus) resilience as more policy is brought in to cover various aspects of the economy.

1.17. The Green Deal in a time of COVID-19



Source: HSBC

EU Carbon Border Adjustment Mechanism (CBAM)

More details on the EU's carbon border tax, now known as the Carbon Border Adjustment Mechanism (CBAM), have emerged. The European Council *Conclusions* of July asked the Commission for a formal proposal "in the first semester of 2021" with a view to introduction by January 2023. The Commission launched a public consultation on the CBAM on 24 July (until 28 October 2020). Possible features can be found in Figure 1.18.

The Carbon Border
 Adjustment Mechanism is
 set to be formally proposed
 in 2021

1.18: Aspects being discussed in the consultations over the CBAM

EU Carbon Border Adjustment Mechanism (possible features)		
Rationale	 Carbon Leakage Transfer of products / economic activity from countries / jurisdictions with stricter to weaker emission regimes	
Possible Application	 Exports  Imports  Both	
Possible Mechanism	 Tax on imports  Extension of the ETS to imports  Allowance purchase outside the ETS  carbon tax at consumption level	
Scope / Benchmarks	 EU ETS And / Or  Value chain emissions  How to determine carbon content	
Possible impacts	 Economic  Environmental  Social  Administrative	
Other issues	 Verification procedures  Anti-circumvention mechanisms  Exceptions	

Source: HSBC (based on European Commission)

The Climate Neutrality law is set to guide Europe to 'net zero' emissions by 2050

EU Climate Neutrality Law (4 March 2020)

In March 2020, the European Commission unveiled its Climate Neutral Law, which is designed to “enshrine” the 2050 climate neutral objective into legislation and provide a “long term direction of travel for EU climate policies”.

2050: Article 1 of the proposed law states: “Union-wide emissions and removals of greenhouse gases regulated in Union law shall be balanced at the latest by 2050, thus reducing emissions to net zero by that date.”

The target will be an EU-wide collective objective, which means that, technically, not all member states have to achieve neutrality individually. For more details, see [The European Green Deal: EU Climate Neutrality Law proposed](#), 5 March 2020.

European Industrial Strategy (10 March 2020)

A week after the Climate Neutrality Law proposal, the European Commission unveiled a new Industrial Strategy under the Green Deal with an objective to transition Europe's industry for the future. The main idea is to transition Europe's industry for the future such that it fulfils three key aims: **climate neutrality**, **competitiveness** and **digital**. However, the strategy is more of a general framework that comes with proposals and plans, many of which are yet to be released, and with many details unclear. We think the general direction towards a climate neutral future is clear, but we await targets and more concrete action plans. For more details, see [The European Green Deal, Climate details lacking in new Industrial Strategy](#), 11 March 2020.

EU Circular Economy Action Plan (11 March 2020)

The European Commission unveiled the next iteration of its *Circular Economy Action Plan* to assist the bloc's transition to circularity and play a pivotal role in its broader climate and economic ambitions. The Commission describes a circular economic model as a “precondition” to allowing the bloc to halt biodiversity loss and, crucially, to achieve its target of becoming climate neutral by 2050. Although the March *Circular Economy Action Plan* was not its first, it was by far the most extensive because it now forms a key pillar within the European Green Deal. For more details, see [The European Green Deal: Circular Economy Plan ambitious but long road ahead](#), 12 March 2020.

The EU has laid out a clear industrial, agricultural and 'circular economy' action plan for climate policy

EU farm to fork strategy (20 May 2020)

The European Commission unveiled its ‘farm-to-fork’ with the underlying aim to ensure the sustainability, quality of, access to, and affordability of food in Europe and beyond. The focus was on maintaining soil and nutritional quality through the reduction in use of pesticides, fertilisers and antimicrobials – with various associated targets for 2030. For more details, see [The European Green Deal, Biodiversity and farm to fork strategies unveiled](#), 22 May 2020.

... but the US has reached a major fork in its climate policy path

In the US, the November elections will determine whether there is a re-engagement with domestic and international climate policies.

The US election is set to deliver a 'fork in the road' for US climate policy

It is fair to say that the US currently has no real climate policy in place, however this may change following the US presidential elections in November. Should the incumbent be re-elected for another term, we expect no change to current climate policy; should the Democratic candidate, Joe Biden, be elected, we expect a substantial re-engagement of climate policies both domestically and in terms of international cooperation.

Democrats Climate Plan (1 July 2020)

On 1 July, the Select Committee on the Climate Crisis, run by the House Democrats, put out their climate action plan (Figure 1.19). This aims for net-zero emissions by 2050. This action plan clearly aims to re-engage the country with global climate diplomacy with an aim to position the party ahead of the election in November.

1.19. Main pillars of the Democrats' action plan (1 July 2020)

Reducing emissions	- Zero-carbon energy sources and infrastructure - Investment in R&D across clean energy technologies - Expand clean energy tax incentives and grant programs - Enact national zero-emission sales standards for cars and trucks (100% by 2035 for cars, 100% by 2040 for trucks) - Clean requirements on residential and commercial buildings
Preparing for disruptions	- Improve water infrastructure to combat flooding - Prepare telecommunications networks for climate resilience - Provide stable federal investment in pre-disaster mitigation
Building resilient communities	- Secure worker rights to organize unions and negotiate safer working conditions - Invest in communities disproportionately impacted by pollution and climate change consequences - Department of Health to develop action plans in preparing for climate-related health risks

Source: HSBC

The Biden climate plan (14 July 2020)

In mid-July, the Democratic candidate for the upcoming presidential election, Joe Biden, unveiled his own climate plan. Mr. Biden was a proponent of addressing climate change during his time as Vice President but has become more vocal after discussions with more progressive members within the Democratic such as Bernie Sanders and Alexandria Ocasio-Cortez.

According to the *Biden plan for a Clean Energy Revolution and Environmental Justice*, the "Green New Deal is a crucial framework for meeting the climate challenges we face" and connects the environment with the economy. We emphasise that the plan is not policy as many parts of it will require funding from Congress as well as legislation to be passed. Also, at this stage, many of the headline statements lack sufficient details – they are only pledges.

The most important target in the Biden plan, in our view, is to ensure the US reaches **net-zero emissions no later than 2050** because this would:

1. Put the US in line with the latest climate science of what is required to limit temperature rises to within 1.5°C;
2. Return the US to a global climate leadership position; and
3. Put pressure on other economies to raise ambition levels.

A Biden presidency would seek to deliver a 'Green New Deal'

There are still significant details that would need to be filled out

Although there were a number of headline pledges, most were lacking in details of how they would be achieved. The ***Biden plan for a Clean Energy Revolution and Environmental Justice*** (joebiden.com/climate-plan/) was released alongside the ***Biden Plan to Build a Modern, Sustainable Infrastructure and an Equitable Clean Energy Future*** (joebiden.com/clean-energy/). We summarise some of the other major pledge points in these complementary plans below.

- ◆ **Power:** Biden pledges to lead the US to become a 100% clean energy economy by investing heavily into clean energy and working towards the power sector being “carbon pollution-free” by 2035. As part of this, the US would invest in “capturing carbon dioxide from power plant exhausts” to decarbonise existing infrastructure as well as “grid-scale storage” to ensure stable supply across various grids as more renewable (and variable) power is incorporated.
- ◆ **Industry:** The plan includes a pledge to decarbonise the “industrial heat needed to make steel, concrete, and chemicals” which would require either a change in the heat source (away from fossil fuels) and / or a fundamental change in the industrial process that makes it more efficient. The US would follow Europe in trying to decarbonise these heavy industries but, in our view, should be wary of carbon leakage.
- ◆ **Transportation:** We think Mr. Biden hits the right areas in transportation but there are no further details as yet. The cleaner transportation pledges are mostly quite standard in its attempts to reduce emissions from the sector. For example, “100% clean energy and zero-emissions vehicles” in terms of government procurement and some half a million more new public charging outlets (for electric vehicles) by 2030. There were two more interesting angles:
 - mentioning carbon-free hydrogen although the context was not clear, and
 - to “provide every American city with 100,000 or more residents with high-quality, zero-emissions public transportation options”.

However, more details are required to ascertain the implications.

More details may be forthcoming in the lead up to the 3 November election

- ◆ **Buildings:** The Biden-plan intends to “set a target of reducing the carbon footprint of the U.S. building stock 50% by 2035” which we think will involve retrofitting buildings to make them more heat and energy efficient as well as control the carbon intensity of electricity used. A Biden administration would start that initiative with “government installations, buildings, and facilities” to ensure that they are “more efficient and climate-ready”.

Other pledges within the Biden two plans

- ◆ **Agriculture** – to decarbonise the food and agriculture sector. It is not yet clear which parts of the agricultural supply chain (from growers to retailers or perhaps all of it) would be targeted.
- ◆ **Investment** – into a number of areas including “federal infrastructure” so that its carbon intensity is reduced as well as more resilient to the impacts of climate change; climate change research and innovation (both mitigation and adaptation).
- ◆ **Disclosure** – in line with some other markets, Biden would require “public companies to disclose climate risks and the greenhouse gas emissions in their operations and supply chains.”
- ◆ **Finance** – develop “new tools to manage and reduce risk and the cost of transferring risk” which would potentially affect the insurance sector.
- ◆ **Methane** – Mr Biden would reintroduce “methane pollution limits for new and existing oil and gas” – something which was legislated by the Obama administration but rolled back by President Trump.

We expect more details on these pledges to emerge during the run-up to the presidential election in November.

Electric vehicle ‘tipping point’ set to support demand for batteries

Lithium and cobalt markets took a further short-term hit as a result of COVID-19

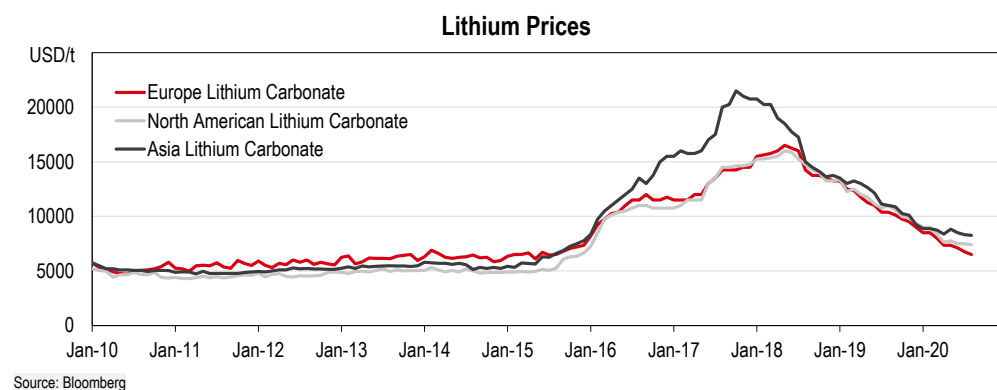
In the short run, somewhat unsurprisingly, the COVID-19 shock has weakened demand for motor vehicles and, in turn, weakened demand for the battery-related materials. This has happened at a time when the markets for lithium and cobalt were already oversupplied. As a result, lithium and cobalt have fallen further the past six months (Chart 1.20).

Even in regions where prices had held up reasonably well before the COVID-19 shock (at cUSD10/kg) they saw 20-30% price reductions. Prices in China, where the oversupply is largely concentrated, continued to slide lower and fell below an average USD4/kg in July, as some lithium producers have opted to prioritise volume over price in the region. In the short run, the risk of further waves of COVID-19 disruptions has kept uncertainty high and prices low.

Lithium is still over-supplied

On the supply-side, as we have described in in previous Global Commodities reports, the battery related materials have been through a ‘super-cycle’ over recent years. After supply ran well below demand, pushing prices sharply through 2016 and 2017, new investment in capacity finally caught up to demand from 2018 onwards, pushing prices significantly lower (see [Global Commodities: Better ... but it ain't a 'super-cycle'](#), 8 March 2018).

1.20. Lithium prices fell further as a result of COVID-19, but the future looks positive

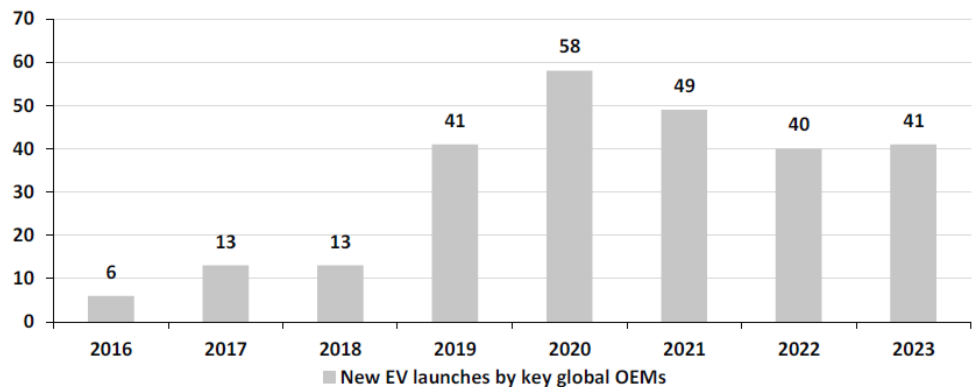


The longer term view is positive, as electric vehicles head to a global ‘tipping point’

Longer term, however, we maintain our bullish outlook for lithium, driven primarily by growth in electric vehicles. Indeed, one of the expected beneficiaries of the changing climate policy discussed above, is expected to be the commodities that underpin the shift to greater use of electric vehicles and battery storage. This includes metals such as copper and nickel, as well as the battery-related materials, such as lithium and cobalt.

The pace of growth in new electric vehicle models has accelerated, and many new models are coming (Chart 1.21). For example, last year, VW Group announced that under its revised electrification plan it would launch about 70 new EV models over the next decade, up from 50.

1.21. The pace of new electric vehicle model launches is accelerating



Source: HSBC, HIS Global. Please note some of the launches in 2020 may get delayed into 2021 due to the impact of COVID19. Key OEMs considered – Audi, BMW, BYD, Chevrolet, Citroen, Ford, GM, Great Wall, Honda, Hyundai, Jaguar, Land Rover, Jeep, Kia, Mercedes Benz, Nio, Nissan, Peugeot, Porsche, Renault, Skoda, Tesla, Toyota, VW and Volvo

The move to electric vehicles is supported by government mandates and subsidies

Much of this has been driven by government policy and targets for electric vehicle market penetration. In the past six months, several countries in the EU have announced additional subsidies with a clear focus on promoting battery electric vehicle and plug-in hybrid electric vehicle demand, while the all-important Chinese market should benefit from its new energy vehicle (NEV) subsidies extended by two years until 2022. Indeed, HSBC's Autos equity research team have recently argued that electric vehicles are on the cusp of a 'tipping point' for market share (see [Electric Vehicles: Global EV progress – Tipping point](#), 27 August 2020). For more details see Chapter 5 below.

Gold and silver strong on the uncertainty

Lower real interest rates, significant monetary and fiscal stimulus and economic uncertainty have supported gold prices

Precious metal prices have been clear winners from the COVID-19 shock. In particular, the unprecedented simultaneous peacetime monetary and fiscal response to the economic and social dislocations of the pandemic is decidedly gold-bullish. As our Chief Precious Metals analyst, James Steel, describes in Chapter 3 below, this provides gold with two important ingredients for high prices: debt and liquidity. Low interest rates in real and nominal terms (and negative rates in some economies), expanding central bank balance sheets, central bank intervention in the economy and huge fiscal packages are all supporting gold prices. The gold price rose to a record nominal high in July (Chart 1.22).

With a bumpy and uneven economic road ahead, James expects gold prices to remain well supported, although he sees further price gains as hard to come by.

1.22. The gold price rose to a record nominal high in July



Source: Bloomberg; Refinitiv Datastream

After lagging behind, silver prices have caught up recently

As gold prices surged from March onwards silver was left behind. This was largely because gold captured investors' attention, while silver was hamstrung by weak industrial demand and jewellery demand. The result was a widening of the gold/silver ratio to historic highs of 1:126. Silver benefited from investors who had either not participated in the gold rally or were reluctant to commit more funds as gold surged above USD2,000 an ounce. More recently, silver prices have played catch-up. Investors turned to silver and prices soared to USD29 an ounce, driving the gold/silver ratio back below 1:70 recently.

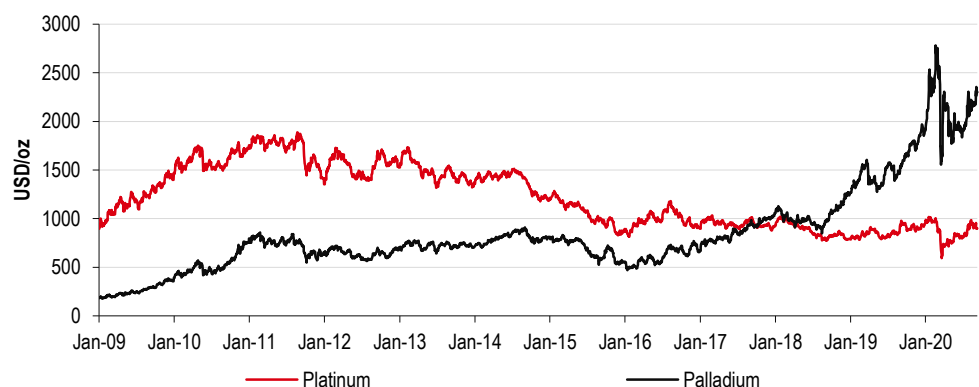
Platinum and palladium heavily affected by COVID-19

Falling motor vehicle production has weighed on palladium, but fundamentals are still highly supportive

For the platinum group metals, the COVID-19 pandemic has resulted in significant changes to demand, most notably via lower auto production and other forms of industrial demand (Chart 1.23). However, at the same time, supply has also been heavily impacted with curbed mine output and decreased auto scrap supplies. As a result, palladium prices fell sharply from record highs earlier this year and may be more stable as previously acute demand concerns and lack of available material ease. HSBC's Chief Precious Metals analyst, James Steel, expects the large deficit in palladium of 2019 will likely narrow considerably in 2020 but expects it to increase in 2021, supporting prices.

Platinum demand is further curbed by reductions in platinum jewellery purchases, notably in China. The result is likely to be a swing in supply/demand balances for platinum from a deficit last year to a small surplus this year, followed by a wider surplus in 2021.

1.23. Palladium prices hit by COVID-19 effect, but still very high on supply shortfalls



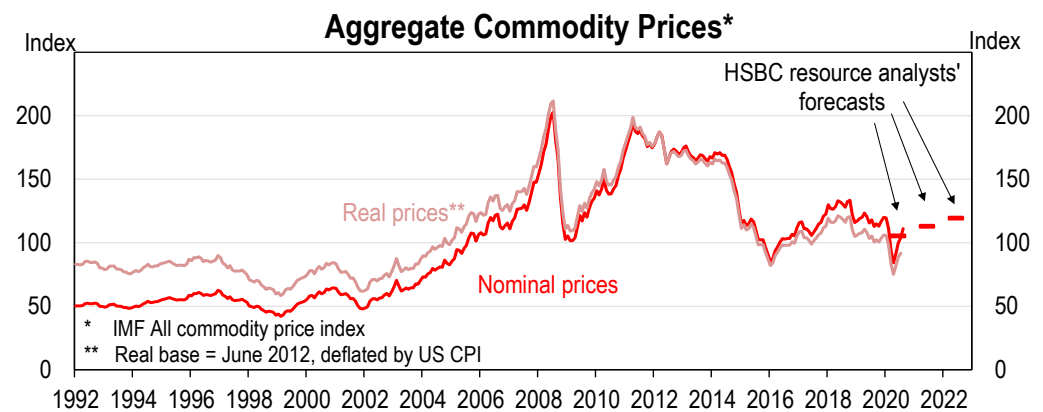
Source: Bloomberg

In sum

Aggregate global commodity prices are expected to remain around current spot levels on average in 2021

The sum of all of these developments is that the global commodity price index, having fallen sharply in early 2020 and since largely rebounded, is forecast to remain broadly steady in 2021 around its current spot price level (Chart 1.24). That would see a 7% rise in the index in 2021, relative to 2020 average, which is expected to have fallen by around 10% from the 2019 level. A further modest gain in 2022 is expected.

1.24. Broadly steady in 2021 from current spot levels and a modest gain in 2022



Source: IMF; HSBC estimates

The outlook is a mixed bag, driven by the expected bumpy and uneven economic recovery

However, this overall picture hides a mixed bag of outlooks for different commodity prices given the bumpy and uneven economic recovery that is expected and the significant uncertainty that still exists (Table 1.25). As was the case six months ago, our highest conviction calls are that the metals are likely to remain well supported, while the outlook for oil and gas is more challenging. The climate change agenda is set to play an increasing role, leaving us long-term bullish on battery-related materials, with includes copper and nickel.

1.25. HSBC's main commodity price forecasts

Commodity	Unit	Spot price	2020f	2021f	2022f	Long term
Aluminium	USD/t	1,762	1,555	1,550	1,575	2,200
Copper	USD/t	6,814	5,724	5,842	5,732	6,614
Nickel	USD/t	15,227	12,408	12,787	13,228	17,637
Zinc	USD/t	2,457	1,939	2,122	2,183	2,337
Iron ore	USD/t	126	86	76	68	65
Thermal coal	USD/t	51	60	65	68	70
Coking coal	USD/t	179	136	145	145	130
Brent	USD/b	40	41.9	50.0	60	60
WTI	USD/b	37	38.1	47.0	57	57
Nymex gas	USD/mBtu	2.29	1.9	2.3	2.5	na
UK spot LNG	USD/mBtu	4.50	2.3	3.4	3.7	na
Beef *	USD/cwt	217	230	228	na	na
Pork (US)	USD/cwt	58	na	na	na	na
Chicken*	US cents/lb	85	92	93	na	na
Sugar (US)	US cents/lb	155	na	na	na	na
Dairy (WMP)	USD/t	2,884	na	na	na	na
Wheat*	USD/t	215	197	197	197	na
Gold (Average)	USD/oz	1,957	1,793	1,965	1,850	1,600
Silver	USD/oz	27.21	21.55	25.50	22.50	22.00
Platinum	USD/oz	961	847	925	1005	1,250
Palladium	USD/oz	2324	2064	2240	2210	1525

Source: Bloomberg, HSBC estimates * World Bank forecasts NA – Not applicable. Spot prices as of 14 September 2020

2. Oil and Gas: An uncertain road ahead

- ◆ Recovery in oil demand has slowed, and significant uncertainty remains over both near-term and longer-term demand outlook
- ◆ Falls in crude supply – voluntary and involuntary – have brought the oil market back to balance, and are likely to keep it tight in 2021
- ◆ We expect the global gas market to stay heavily oversupplied, not just in 2020, but also through 2021 and 2022

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Despite a strong bounce-back in 2021, we don't see global demand returning to 2019 levels until 2023/24

Oil markets back into balance, but demand uncertainty is high

At its worst, we calculate the collapse in oil demand led to a global oversupply of around 18 million barrels a day in April. Since then, huge moves in both supply and demand have brought the market back into deficit on our estimates.

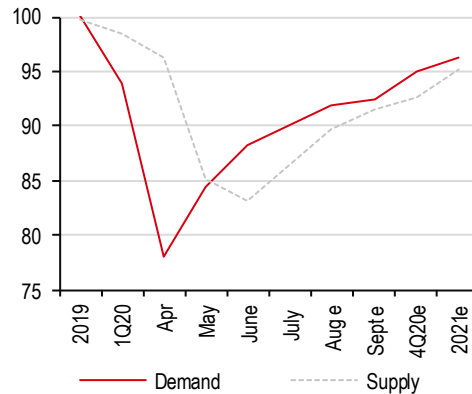
- ◆ We estimate that global demand recovered from a low of 78 million barrels a day in April to ~90 million barrels a day in July as lockdown restrictions eased and economies reopened (Chart 2.1).
- ◆ Meanwhile, supply fell by ~10 million barrels a day between April and July, with OPEC supply down by ~7 million barrels a day, although it has since risen as the OPEC+ group has moved to the second phase of its agreed cuts.

However, in recent weeks we have seen signs of a stalling in the pace of the demand recovery, particularly in jet fuel – see [Global demand: stalling in 3rd gear](#) (26 August 2020). Nevertheless, we see demand recovering to around 95mbd in 4Q (Chart 2.2). This would give full year demand of 91mbd, down 9mbd (9%) y/y. We expect demand to bounce back by 5.3mbd (5.8%) in 2021, but we don't see it surpassing 2019 levels until 2023/24.

In our view, the biggest uncertainty for the oil market at the moment is around the pace of demand recovery. There is a clear disparity in the rates of recovery in different countries as well as in different products.

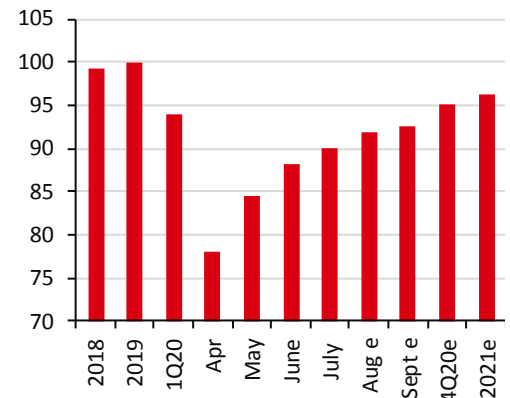
Road fuel demand has recovered quickly in line with mobility indicators but jet fuel demand is still 4mbd (60%) below 2019 levels. The robust recovery in mainland China's oil demand to above pre-COVID-19 levels is the exception rather than the norm. Outside mainland China, the demand recovery seems to have stalled in July/August – with clear evidence of flattening growth in India and the US in particular, where demand is still down 0.5mbd (10%) and 3mbd (14%) respectively y/y.

2.1. Global supply/demand: actual/estimates, mbd



Source: IEA, HSBC

2.2. Global demand: actual/estimates, mbd



Source: IEA, HSBC estimates

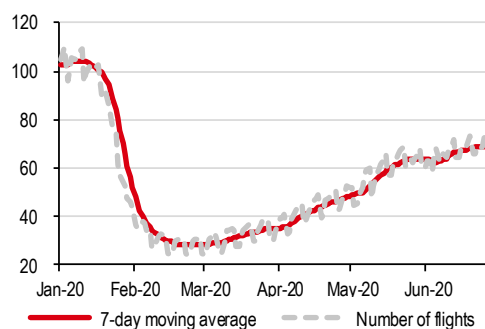
Jet fuel demand still less than half its pre-COVID levels

Jet fuel demand: down 4mbd vs pre-COVID-19 levels

Global commercial flight numbers have doubled since the April average of 30,000, reaching 61,000 in June. The rate of growth slowed substantially in July with commercial flights averaging 66,000 over the month – down from 100,000 flights pre-COVID-19 – and have remained at a similar level in August despite the summer months being seasonally the strongest for airline travel (Chart 2.3). The majority of these flights are also short-haul rather than long-haul, and likely to be less fuel intensive on average.

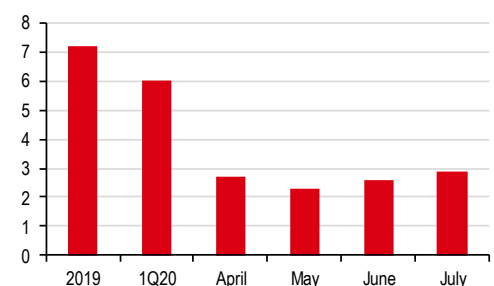
In 2019, global aviation fuel demand was ~7mbd; this fell to ~2.5mbd in April and May and only recovered to 3mbd in July (Chart 2.4). Given the flattening growth over the busiest summer months, it is looking unlikely that the remaining 4mbd of 'lost' demand will be recovered any time soon. The International Air Transport Association (IATA) estimates that airlines won't reach 2019 traffic levels until 2024, having previously expected a recovery by 2023, suggesting jet fuel demand might remain a drag on global demand for at least the next four years.

2.3. Total number of commercial flights, '000



Source: Flightrader24

2.4. Global jet fuel consumption, mbd



Source: Rystad Energy

US demand recovery stalling

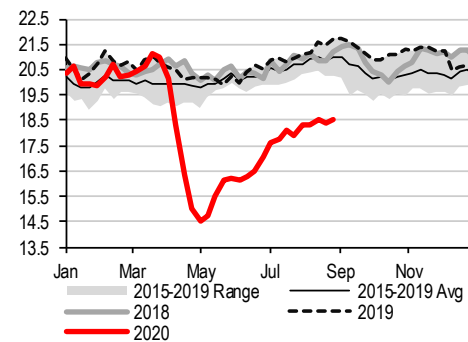
US demand recovered quickly but is starting to stall

The weekly EIA data show that US demand bounced back quickly from 14.5mbd (-28% y/y) at the end of April to 18.3mbd (-13% y/y) at the end of July (Chart 2.5). However, the speed of recovery is clearly slowing with demand pretty much flat from July to August. Furthermore, some of the recovery is seasonal and overall product demand remains c.3mbd (15%) below seasonal norms.

US gasoline demand is still down 1mbd (10%) y/y

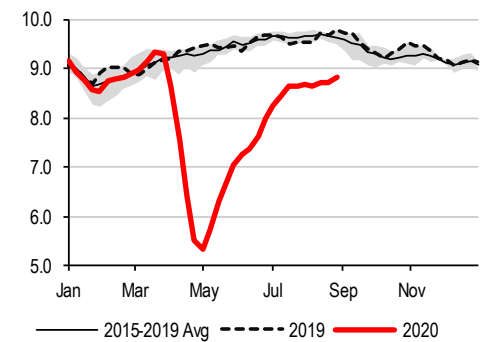
The return of gasoline demand has been pivotal to the US recovery, but demand has recently flattened off at around 8.8mbd – a level still down 1mbd (10%) y/y (Chart 2.6). The recent lack of growth in US gasoline demand is a concern for the market as gasoline demand is likely to weaken seasonally from September onwards, and federal payments related to COVID-19 also rolled off at the end of July – reducing potential discretionary spending.

2.5. US oil product demand, 4wk rolling ave, mbd



Source: EIA, HSBC

2.6. US gasoline demand, 4wk rolling ave, mbd



Source: EIA, HSBC

The weekly data for distillates show a steady recovery from May as freight and industrial activity has recovered. US distillate demand is just 0.2mbd below 2019 levels although distillate inventories remain very high – up 35mb (24%) against the 5-year average – putting continued pressure on refining margins.

US jet fuel demand recovered sharply in June/July but has subsequently started to weaken in August – a worrying sign given August is seasonally one of the strongest months for air travel. On a 4-week rolling average, jet fuel demand in mid-August was down 0.9mb (46%) from 2019 levels.

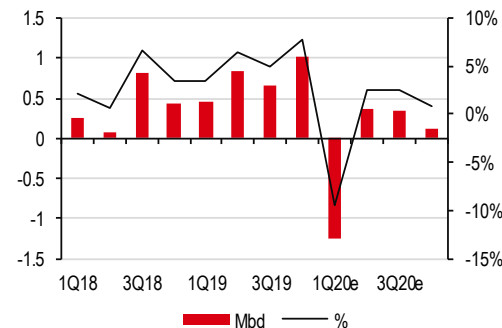
China demand growth – strong for crude and products

The recovery in mainland China's demand has been remarkable and has surprised many in the market. Although real time data are hard to come by for mainland China, the latest estimates suggest mainland China's apparent oil demand reached 14mbd in July (vs 13.7mbd in FY2019) – a new record and up over 3mbd from the March lows. On a quarterly basis, mainland China's oil demand was 0.36mbd higher y/y in 2Q – an impressive bounce-back from the 1.25mbd y/y decline in 1Q 2020 (Charts 2.7 and 2.8).

The near-term economic data for mainland China is supportive of continued growth in oil demand with our economists recently upgrading their mainland China 2020 GDP forecast to 2.4% (vs 1.7%) – see [Greater China Economics: Turning more positive on mainland China 2020 growth](#), 24 August 2020.

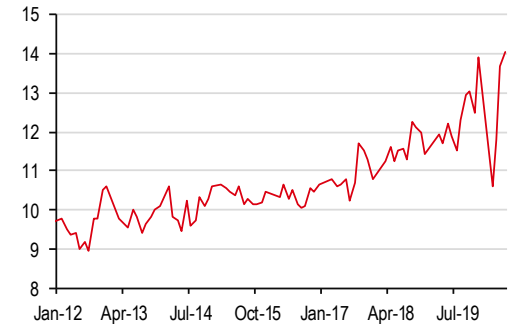
Mainland China demand is back above 2019 levels

2.7. Mainland China oil demand, y/y change in mbd and %



Source: IEA

2.8. Mainland China apparent oil demand, mbd



Source: Bloomberg

Supply side is adjusting to continued demand weakness

The recent demand data suggest that the recovery from here will be slow, which could be a headwind for crude. However the supply side dynamics remain supportive of prices and we believe they will be enough to tighten the market over the second half of the year and beyond – see our report [Inflection point](#), 3 August 2020. We see three important supply-side trends:

1. OPEC+ remains committed to its supply agreement, and reiterated its determination to rebalance the market at the Joint Ministerial Monitoring Committee (JMMC) on 19 August. OPEC+ compliance remains reasonable at 87% for OPEC-10 in July. From August, the agreement provides for an increase in supply of ~2mbd vs the agreed May-July levels, although this increase may prove to be less if – as it seems – we get overcompensation for a previous lack of cuts from the likes of Iraq.
2. There is no sign of a recovery in US supply – US crude volumes are down 2.4mbd from the March high and the latest well completion data showed well completions fell for the fifth consecutive month in July, with total US completions down 80% y/y. The weekly data show the rig count may have finally bottomed out in mid-August, while the frac count (no. of completion crews operating) is only marginally above its May lows. We think US activity levels are far below those needed even to stabilise supply, pointing to a further decline in US output in 2021 after what we expect to be a 1.6mbd full year average decline in 2020 – see our report [Temporary recovery, followed by further decline](#) (13 July 2020).
3. We believe 2019 will prove to have been the peak for non-OPEC conventional production – while we expect a good recovery in 2021 without the effect of 2020 shut-in volumes, we don't see output regaining 2019 levels. Beyond 2021 we think underlying decline rates, a lack of major new growth projects and an increasing trend of capital allocation away from oil by the European majors all point to a gradual decline in non-OPEC conventional supply over time.

Overall, we expect to see the market tightening for the remainder of 2020 and into 2021. Although the demand recovery is slowing, we still see room for OPEC to raise output over the coming months and into 2021. On our numbers we see OPEC-10 volumes rising by 3.5mbd in 4Q vs July due to our expectations of rising demand. However, if anything we expect OPEC+ to err on the side of caution, and only increase supply significantly if it is convinced this would not result in a return to oversupply.

As demand improves further in 2021 and US supply continues to decline, we see room for OPEC-10 to expand market share and grow volumes by 4.3mbd y/y in 2021.

A combination of OPEC+ supply cuts and a sharp fall in US activity continues to offset demand weakness

We still expect the global market to be oversupplied by an average of 1.1mbd in 2020, but this is very much a tale of two halves with a 4.5mbd y/y oversupply in 1H, and a 2.3mbd undersupply in 2H. Thereafter, we expect further tightness in the market in 2021, with an average decline in inventories of 1.1mbd for the year, despite our assumption of OPEC-10 supply for the year another 1mbd higher than in 4Q, or ~3mbd higher than in August/ September. For further detail, see our report [Oil things considered: Inflection point](#), 3 August 2020.

Longer-term demand – climate and COVID add to the uncertainty

The longer-term outlook for oil demand is clouded not just by possible structural effects as a result of the COVID pandemic, but also because of a number of other climate-related issues.

Europe backs its net-zero ambitions with huge stimulus package

The EU has announced what has been billed as ‘the World’s largest climate stimulus package’

The European Union (EU) first laid out its vision to be emissions-neutral by 2050 in November 2018, with this objective formally endorsed by the European Council in December 2019. More recently, in July EU members formally approved what has been billed as the World’s largest climate stimulus package aimed at accelerating action to reduce emissions across the region. The EU’s EUR1.8trn economic recovery plan and 7-year budget includes more than EUR500bn of green stimulus measures covering transport, hydrogen, CCS and buildings (insulation, solar roof panels).

The EU’s plans provide one of the clearest examples of how some oil companies translate national or regional policy conviction into company strategies – Total has shaped some of its own ‘net zero’ aspirations so as to mirror policy actions in Europe.

US election adds considerable policy uncertainty

The US election adds considerable policy uncertainty

As the US Presidential election approaches, the differences in potential US climate policy from the two possible outcomes look stark. The Democratic Party has called for strong action on climate change – in contrast to the current administration, which has rolled back a number of environmental regulations.

More specifically, Democratic Party Presidential nominee Joe Biden’s plan for clean energy and climate looks very progressive and would have implications for US domestic oil and gas production, US energy demand as well as US international energy policy. The overarching goal (somewhat mirroring the ambitions of the EU) is to fully decarbonise the US economy, or achieve ‘net zero’ emissions by 2050 through a combination of supply-side and demand-side policies coupled with ‘green’ fiscal stimulus and re-joining the Paris Agreement. For further detail, see our report [US elections and oil: Possible impact on energy markets if Joe Biden wins](#) (27 July 2020).

IEA sustainable recovery – a historic opportunity at a testing time

Prior to the COVID pandemic, the IEA’s long-term Energy Outlook illustrated the scale of the range of possible outcomes for oil demand, dependent on progress on climate initiatives. In its reference case, the agency saw 2040 global liquids demand of ~110mbd, compared to around 100mbd in 2019. Meanwhile its Sustainable Development scenario – a vision of how the energy sector could evolve in a way consistent with the goals of the Paris Agreement – oil demand falls to only around 75mbd. However, the world has obviously changed with the COVID-19 pandemic, which we expect to have cut global demand to an average of around 91mbd in 2020.

COVID-19 may lead to a significant shift in policy objectives and priorities

The post COVID-19 world is poised to witness changes in policy objectives and priorities across a range of issues – including energy and climate – however it is still, in our view, too early to definitively say whether overall energy transition momentum will accelerate or stagnate in the short term. We believe heightened uncertainty is a key factor around policy development, with potential impacts for the oil & gas industry’s own decision making.

The IEA's *Sustainable Recovery* proposition is relatively simple: global energy-related emissions hit an all-time peak in 2019 and are set for an historic 8% decline this year – there is probably no better time to make structural changes to global energy supply and use in order to get on course to deliver the goals of the 2015 Paris Agreement. The policy framework – developed with the IMF – also delivers job growth and air quality improvement on paper, but would crucially thwart an emissions 'rebound' (akin to that of 2009 following the financial crisis). With clean energy technology costs structurally lower than a decade ago, and a global climate agreement to act on climate change, there are more reasons to suggest that a diversion from a several-decades-long path is possible.

A mix of other policy moves

At the country-specific level, we have seen policies which are both positive and negative for the outlook for oil. A recent (temporary) change to **Norwegian** oil & gas investment taxes allows operators to immediately offset investment costs against payable tax, rather than over a number of years as previously. This has helped the economics of offshore oil & gas projects almost overnight and two developments (Hod and NOAKA) have moved ahead since the announcement. However, in terms of climate policy it should be noted that Norway has a roughly EUR50/t offshore CO₂ tax that applies to direct emissions from oil & gas production (which is payable in addition to EU ETS allowances). The country has also recently sanctioned a large carbon capture and sequestration project (to capture 1.5mt CO₂ pa, at a cost of USD675m) and unveiled a funding package for hydrogen development in the order of USD350m.

Meanwhile, in **India** the government have been seeking to raise funds through tax increases on diesel and petrol prices – duty now represents ~50% of average 'pump prices' after a 12-week price freeze during lockdown was lifted. India represents around 5% of global oil demand, and crucially for oil producers, is a key consumption growth market (alongside China).

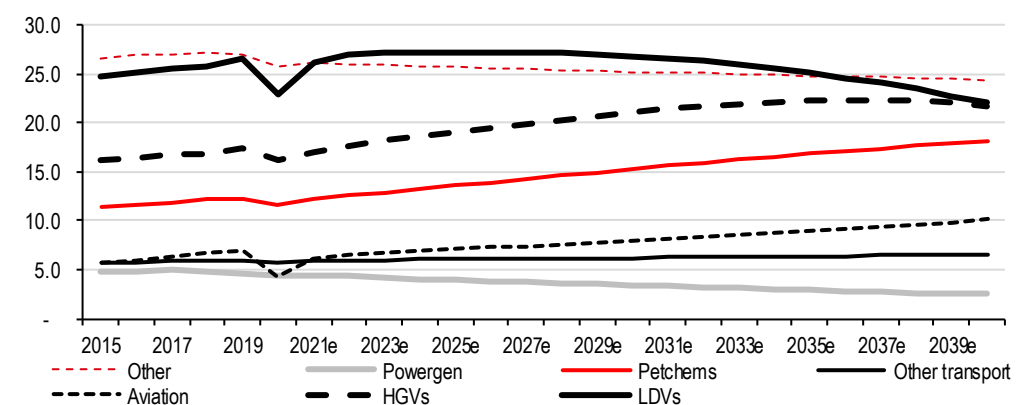
Longer term threats to oil demand from behavioural changes

We recently revised our longer-term oil demand assumptions to account for the COVID-19 demand collapse in 2020. While we still see oil demand peaking the early 2030s, the potential changes in consumer behaviour due to COVID-19 add greater uncertainty to the outlook for oil product demand. The potential structural changes in consumer and business behaviours could lower the trajectory of global oil demand growth beyond 2020 with the greatest uncertainty surrounding the jet fuel and gasoline outlook – which combined made up one-third of total oil demand in 2019.

Norway has made policy adjustments that markedly improve the economics of offshore oil and gas projects

There are longer term threats to the oil demand outlook from behavioural changes

2.9. Oil demand by end-use, 2015-2040 (mbd)



Source: BP, IEA, HSBC estimates

The COVID-19 shock has changed behaviour and there is considerable uncertainty about how much change will become permanent

In our core scenario, we assume that electric vehicle (EV) penetration of the fleet rises to 40% of new sales by 2040 – making up 19% of the global fleet by then. Our assumption for the average annual improvement in fuel efficiency of new sales of Internal Combustion Engine (ICE) light duty vehicles (LDV) is 1.5% pa. However, both the fuel efficiency and EV penetration assumptions could be impacted by COVID-19 with potentially lower vehicle scrappage in the near 2-5 years slowing both EV penetration and fuel efficiency gains.

Some of the potential changes to oil product demand brought on by behavioural changes as a result of COVID-19 are:

Gasoline

- ◆ **More working from home (net negative):** Commuting has typically accounted for around 35% of total car miles driven in economies such as the US and the UK. To the degree that working from home becomes a permanent feature of modern working life, there could well be a structural decrease in vehicle miles travelled. Some of this lost demand could be offset if cars are favoured over public transport for commuting.
- ◆ **More online shopping (net negative):** The surge in online shopping during the pandemic has built up the online infrastructure and logistical capacities of many retailers. If a greater share of the retail wallet moves towards online purchases on a more permanent basis, demand incurred by the need to drive to shops could be lower than in our base case.
- ◆ **Higher unemployment (net negative):** The overall economic fallout of COVID-19 is still highly uncertain, but it is likely that unemployment will remain elevated for the next few years, reducing discretionary spending.
- ◆ **Lower vehicle scrappage (net positive):** It is possible that COVID-19 results in lower vehicle turnover (scrappage) if a weaker economy reduces consumers' ability to upgrade cars. Lower pump prices could also reduce the incentive to upgrade to more fuel efficient vehicles. Lower scrappage levels would result in less fuel-efficient cars being on the market for longer and less sales of more efficient vehicles.
- ◆ **Cars used more for long distance travel (net positive):** Consumers are favouring road over air travel for longer distance travel for both pleasure and business, a trend that could persist.

Jet fuel

- ◆ **Bringing forward the scrapping of older fleets (net negative):** The reduction in air travel requirements has brought forward the retirement of older, less fuel-efficient aircraft as airlines looks to streamline their fleet size. For example, British Airways announced it will retire its entire 747 (jumbo jet) fleet earlier than expected due to COVID-19 (BBC, 17 July 2020).
- ◆ **Less business travel (net negative):** The adoption of digital and remote working practises in business is likely to stay. The number of face-to-face meetings and business conferences is likely to remain depressed relative to pre-COVID-19 levels, as businesses look to make virtual practises permanent.

Diesel/gasoil

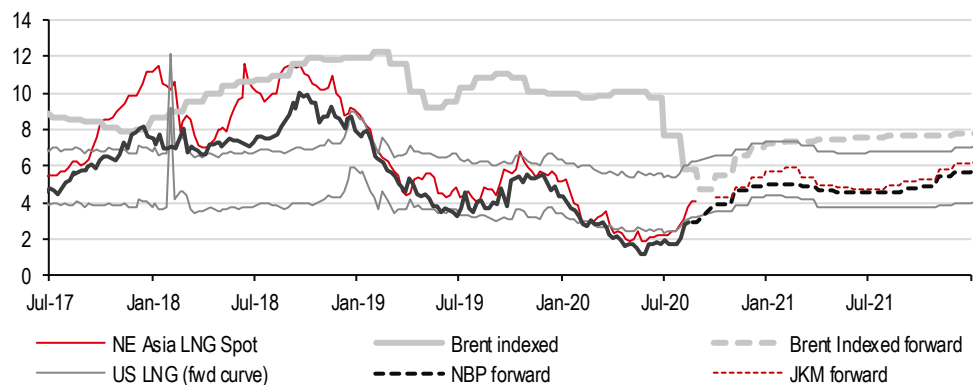
- ◆ It is unclear if there will be a direct structural change in the end use for middle distillates due to COVID-19. Distillate demand is closely related to freight and industrial activities which have all been negatively impacted by the broader economic downturn and the reduction in trade. A higher share of home delivery services would increase 'last mile' freight demand but this is also the area of the freight market that is most vulnerable to disruption from low-tonnage alternative fuel vehicles. The impact on the demand for heating oil is also unclear, with the reduction in commercial building demand likely offset by an uptick in residential heating.

Global Gas and LNG: A deflated market

This section summarises views from our recent thematic report (see [Global Gas: A deflated market](#), 5 July 2020). We expect global gas demand to fall by 4% in 2020, the largest demand shock in recent history. Spot gas prices in Europe and Asia hit record lows in June, with prices down ~70% from 4Q19 and converging towards US Henry Hub prices.

Spot prices have since staged a tentative recovery on the back of hot weather in the US (supporting air conditioning demand), lengthy scheduled maintenance at Gorgon LNG and shutdowns at US Gulf Coast export plants in the wake of hurricane Laura. Oil-linked gas prices held up until mid-year but have fallen dramatically in the past couple of months, reflecting the collapse in crude prices with a c.6-month time lag.

2.10. Price convergence as US Henry Hub drags down European and Asian spot prices Global gas prices (USD/mbtu)



Source: Refinitiv Eikon for historical prices, forward curves (dotted lines)

Gas market would have been oversupplied, even without COVID-19

Medium-term outlook – oversupply through 2020-22

It's important to note that the gas price collapse of 2020 owes as much to the COVID-19-induced demand shock as to rising LNG supplies outpacing demand. Strong LNG supply additions since 2016 led to weak gas market fundamentals in 2019 and a storage glut in Europe. European and Asian LNG prices hit extremely low levels in summer 2020, forcing supply curtailments of piped gas (largely from Russia) and LNG (mostly in the US). These significant supply reductions have helped to avoid gas storage in Europe hitting "tank tops" and supported prices in recent weeks.

We expect global gas market will stay oversupplied in 2021-22 ...

We expect the global gas market to stay heavily oversupplied, not just in 2020, but also through 2021-22. Even as global gas demand recovers next year, we think the persistent storage surplus in Europe will again require low global prices and supply curtailments to balance the market in summer 2021 and possibly in 2022.

China won't come to the rescue this time around. China's LNG imports are up 10% y/y YTD despite the pandemic, but this is far from enough to absorb excess supplies. Although mainland China gas demand growth should remain solid at 6% p.a. to 2025, we expect three-quarters of this demand growth to be met by growing domestic and pipeline gas supplies, leaving less space for LNG imports than in recent years.

... then briefly return to balance in 2023-24...

Longer-term outlook – short-lived balance in 2023-24, then glut returns in 2025+

The gas market will get a short breather and revert back to balance in 2023-24 as liquefaction capacity additions finally slow down, allowing demand to catch up – but we do not expect it to be particularly tight.

... before the glut returns in the mid-2020s

Any new project approvals are likely to worsen the glut

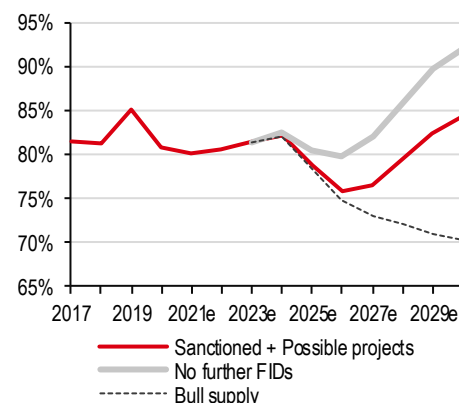
We expect US export terminals to stay under-utilised

The next wave of supply from projects already under construction will then hit the market in the mid-2020s, tipping it once more into oversupply. Capacity additions in 2024-26 will average 23 mtpa per annum – the result of record project FIDs in the last two years – and once again exceed underlying demand growth (~16 mtpa as a long-run average).

No FIDs needed until 2022; any project sanctions are likely to worsen the glut: Given the amount of new capacity approved in the last two years, we believe the world doesn't need more project approvals (Final Investment Decisions or FIDs) until 2022-23 – or else oversupply should be even worse. But a few projects will probably be approved despite a challenging market backdrop, notably the Qatar expansion. If this happens, as we think it will, the glut will be worse and will last a few years longer – almost until the end of this decade on our estimates.

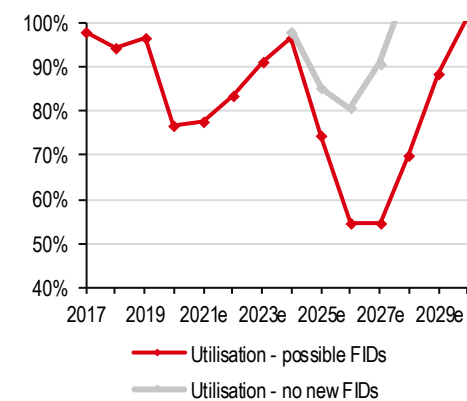
Low US utilisation through most of this decade: Our analysis shows that global LNG utilisation rates will likely stay sub-optimal for a lot longer than the market expects. The US is a key source of flexibility for the global LNG market. As such, US export terminals could be under-utilised, not just in 2020, but through most of this decade until markets tighten again. We expect large-scale US cargo cancellations to continue in 2021-22 with utilisation rates around 80%. US utilisation rates could fall to the mid 50% in 2026-27 in our base case scenario.

2.11. Global LNG capacity utilisation under 3 supply scenarios (%)



Source: HSBC estimates, company reports, BP Statistical Review. NB: Utilisation is defined as LNG demand relative to global nameplate – not effective – capacity

2.12. US capacity set to be under-utilised through much of this decade



Source: HSBC estimates

HSBC gas price forecasts

Gas price forecasts. In a recent report (see [Global Gas: A deflated market](#), 5 July 2020), we cut our European and Asian spot gas price forecasts by 20% to USD3.4-3.7/mbtu and USD4.1-4.5/mbtu in 2021-22 respectively, close to the cash cost of US LNG. Our price assumptions are below the current forward curves. In a loose market where US liquefaction capacity is under-utilised, we believe the short-run marginal costs of US LNG will act as a cap on prices rather than a floor. Just as the rise of shale ushered in a decade of low US natural gas prices, the rise of US LNG exports could put sustained pressure on global prices through this decade. Our mid-cycle prices of USD5/mbtu for Europe and USD6.1/mbtu for Asia do not offer an economic return for many proposed LNG projects.

2.13. Gas price assumptions (USD/mbtu)

	2017	2018	2019	2020e	2021e	2022e	2023e
US Henry Hub	2.96	3.07	2.53	1.87	2.25	2.50	2.55
UK spot gas	5.85	7.87	4.86	2.35	3.38	3.68	5.00
Asia spot LNG	7.10	9.70	5.49	2.84	4.10	4.53	6.13
Oil-linked LNG	8.20	10.58	10.65	8.19	8.00	8.50	8.67

Source: HSBC estimates, Refinitiv Eikon

3. Metals: A bright spot

- ◆ Demand for metals has picked up, particularly supported by China and its infrastructure-led economic recovery
- ◆ Focus has shifted to supply disruptions, which is lending further support to metals prices
- ◆ Copper, palladium, gold and rhodium are our most preferred commodities; iron ore is our least preferred

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Metals prices making an about-face

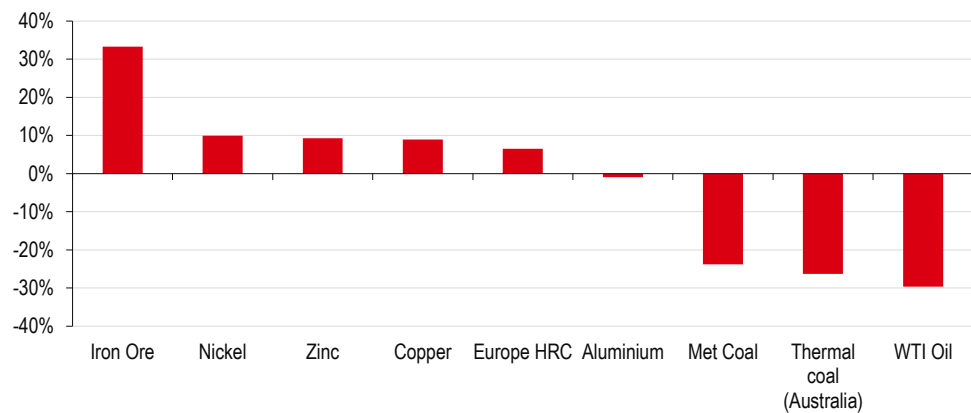
Mainland China's economic recovery post COVID-19 has been faster-than-expected, though it is highly uneven. Our economists believe that private consumption is likely to continue to lag, but growth in infrastructure investment looks set to accelerate further in the coming quarters on continued funding support from both the central and local governments.

This, along with strong property sales and investment, will likely boost demand for upstream industries and create more construction jobs in H2. Coming off a stronger-than-expected GDP print in Q2, our China economists recently raised HSBC's full-year GDP projection for 2020 to 2.4% y-o-y, from 1.7% previously, which is now just ahead of Bloomberg consensus of 2%. HSBC's 2021 GDP projection remains unchanged at 7.5% y-o-y. For details, please see [Greater China Economics: Turning more positive on mainland China 2020 growth](#), 24 August 2020.

Outside China, most global economies have resumed operations, gradually coming out of COVID-19 related lockdowns. Last quarter, most governments across the world imposed restrictive measures to curtail the infection's spread, which resulted in sluggish economic activity and depressed international trade. With the economic re-opening, there is some sense of recovery in demand, at least compared to 2Q20. The acceleration in virus cases in Latin America, India and parts of the US is particularly concerning, given the potential impact on economic growth and supply chains. HSBC economists forecast a contraction in global GDP of 4.8% in 2020, but expect a rebound of 5.1% in 2021. The team believes the recovery will not be linear. After the initial bounce, the pace of incremental improvement could be gradual. For details, please see [The not-so-grand re-opening](#), 30 June 2020.

Following the resumption in activity across the globe, most commodity prices have staged a recovery from their recent lows, however the degree of recovery varies across commodities. Amongst base metals, copper has recovered 42% from their y-t-d lows, while aluminium has shown a more moderate recovery of 22%, due to weaker fundamentals offsetting the pick-up in demand. Among the bulks, iron ore is 52% above its y-t-d lows, supported by resilient demand and supply disruptions y-t-d, while seaborne coal prices continue to be near their yearly lows on China import restrictions combined with a slower pace of ex-China recovery.

3.1. Impact of the coronavirus on metal prices – YTD performance (as of 28 August)



Source: CRU, Refinitiv Datastream, HSBC

Commodities in the non-precious space benefitting from supply disruptions as well as strong demand

Copper prices recovered sharply from their y-t-d lows as global economies started opening up post COVID-19 related lockdowns. Spot price is hovering around USD3/lb. Most base metals have staged a rebound, with copper being in the lead.

In addition to favourable demand, copper has also benefited from concerns of supply disruptions at copper-producing regions, especially in LatAm, amidst increasing number of COVID-19 cases. The copper price rally was supported by: (1) increasing concerns over supply; (2) the pick-up in economic activity in China; (3) lower copper inventories; (4) improving investor positioning; and (5) expectation of major infrastructure push globally.

LME copper inventories declined to the lowest level since 2006 and are at 90.8kt. The inventory level has more than halved in the past three months, implying recovering demand. Nickel prices have also increased and reached levels last seen in November 2019, finding support from supply disruptions stemming from COVID-19, which has led to current tightness in ore supply. Year-to-date, nickel ore exports from Philippines to China is down 20% y-o-y.

Iron ore prices have risen strongly in 2020, with spot price above USD120/t and are up more than 30% YTD. Prices have held above USD100/t since the beginning of June, and above USD120/t since early August, finding support from stronger than expected demand from China and supply disruptions in Brazil. Chinese steel production has surprised to the upside year-to-date, increasing by 2.8% (July output was up 9% y-o-y), despite strong production last year and the COVID-19 impact in 2020, which has led to stronger iron ore consumption, as evidenced by imports increasing 12% y-t-d.

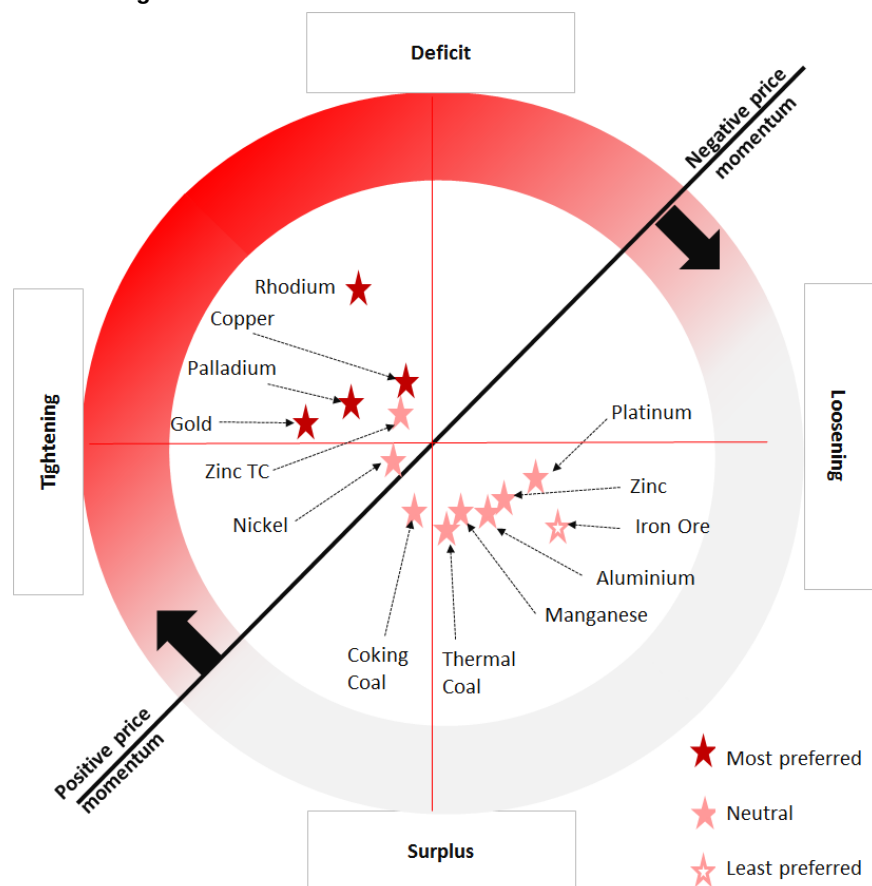
Iron ore supplies were impacted in the first half of the year on unfavourable weather in Australia and Brazil in Q1 and then the impact of COVID-19 and related lockdown. However, shipments from the world's two largest producers have gradually started gaining momentum, which is likely to cause some correction in prices in 2H20. Further strength in China's steel production and/or any further supply disruption from COVID-19 or potential increase in China-Australia tension will likely keep the iron ore market in a deficit into 2021 and iron ore prices stronger for longer.

Preferred metals and price outlook

Based on our Commodity Scanner and ranking the commodities on their pricing outlook, we rank copper as one of our preferred metals as we see a heightened risk of supply shock. The copper market is hanging in tight balance, and further supply risks should support prices. The market is well supplied in the medium term but delays in the start-up of committed projects could change the situation swiftly. We are seeing some deferments in the start of projects. More investment is required in the long term to meet incremental demand and address depletion in existing production.

We also have palladium (supply concerns) and gold (safe haven status and ETF demand) as our most preferred metals, along with rhodium (on tightening NOx). Our commodity price forecasts assume a path of tentative and occasionally interrupted re-openings, but there is a risk of a broader second wave of the pandemic that could again force stringent measures amid rising global infections.

3.2. Commodity Scanner: charting the dynamics impacting key commodities within our coverage



Source: TC/RC refers to Treatment Charges and Refining Charges; Source: HSBC estimates

3.3. Ranking our commodity universe

Commodity	Key catalysts	Comments
Most preferred		
Rhodium	Tightening NOx emission standards	Supply and demand forecast to contract
Palladium	Primary and recycled supply disruption should partially absorb weak demand	Gradual V-shaped recovery in autos to support demand
Gold	COVID-19 inspired safe haven demand, strong ETF demand	Massive global fiscal and monetary stimuli highly supportive
Copper	Further supply disruptions; pick-up in demand	Concerns of supply disruption supporting prices
Neutral		
Nickel	Rate of recovery in stainless steel production	Indonesian NPI supply will continue to increase
Platinum	Investment demand is improving	Weak autos and jewellery demand
Aluminium	Sustained economic recovery from COVID-19	Sluggish global demand; inadequate supply response
Zinc	Revival of economic activities; aggressive supply cuts	We see market remaining in surplus until 2023e
Met Coal	Strong crude steel production	S/D imbalance weighs on met coal prices
Thermal Coal	Ex-China economic recovery	Seaborne demand recovery will be gradual and limited in the year
Manganese	Inventory overhang, moderating demand from China steel industry, temporary supply disruptions	Normalise towards marginal cost support levels
Least preferred		
Iron Ore	Recovery in Brazil supplies; China demand stability	Might be reaching an inflection point in the market

Source: HSBC

3.4. Global supply/demand balance

	2020f	2021f	2022f	2023f	2024f	CAGR 2020f- 24f (%)*
Aluminium (kt)						
Production	62,596	66,166	67,981	70,794	71,824	2.4%
Consumption	61,314	63,887	66,594	69,418	71,864	1.9%
Balance	1,282	2,278	1,387	1,376	-41	
Copper (kt)						
Production	22,807	23,723	24,659	25,268	25,352	1.5%
Consumption	22,698	23,518	24,293	24,757	25,145	1.2%
Balance	109	205	366	511	206	
Iron ore (mt)						
Production	2,309	2,434	2,468	2,459	2,443	0.2%
Consumption	2,313	2,411	2,423	2,404	2,385	-0.8%
Balance	-5	23	46	55	57	
Nickel (kt)						
Production	2,435	2,593	2,794	2,865	2,900	3.6%
Consumption	2,298	2,441	2,705	2,829	2,880	3.4%
Balance	137	152	89	36	20	
Zinc (kt)						
Production	13,762	14,023	14,194	14,436	14,585	1.5%
Consumption	12,929	13,574	13,910	14,196	14,576	0.9%
Balance	833	450	284	241	9	

*Represents change from 2020e start until 2024e end. Source: HSBC estimates

3.5. HSBC commodity price estimates

Commodity (USD/t)	Current spot price	2020f	2021f	2022f	Long term
Aluminium	1,762	1,555	1,550	1,575	2,200
Copper	6,814	5,724	5,842	5,732	6,614
Nickel	15,227	12,408	12,787	13,228	17,637
Zinc	2,457	1,939	2,122	2,183	2,337
Iron ore	126	86	76	68	65
Thermal coal	51	60	65	68	70
Coking coal	179	136	145	145	130

Source: Refinitiv Datastream, HSBC estimates. Spot prices as of 14 September 2020

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COVID-19 has exacerbated the problems faced by the aluminium market, which was already struggling with muted demand in 2019

We believe more cuts are needed as demand in RoW could contract sharply by c10% in 2020

Aluminium: A big surplus seems likely

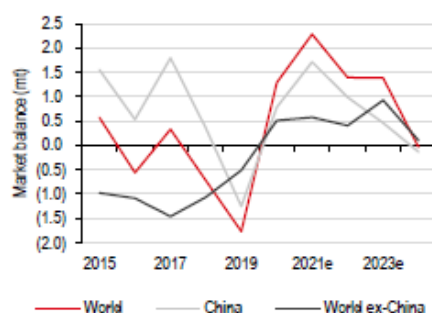
Despite weak fundamentals, the LME aluminium price has recovered 22% from its y-t-d lows. Aluminium prices have been simply following the rest of the base metal complex on its way up. The metal got a further boost from the sharp rise in the SHFE prices, which have benefited by China's targeted stimulus measures and low credit terms. Higher LME prices are therefore simply a reflection of the market closing the gap between two markets as well as with other base metals.

Notwithstanding the run-up, aluminium's price recovery has been the mildest amongst all base metals, and is still down 2% y-t-d. This is primarily because of weaker fundamentals and slowing end segment demand. With LME moving above USD1750/t, we believe aluminium has decoupled from the underlying market fundamentals. At these high levels we find no incentive for the supply side to trim output. We forecast the aluminium market to move into surplus in 2020 and remain in surplus through 2023, before seeing a small deficit in 2024. We expect prices to remain constrained unless there is further supply consolidation. Damage to demand and an uneven restart of economies in the outside of China, mean that even with better demand than our base case, large surpluses seem likely. We expect CY20 prices to average USD1,555/t. We expect fundamentals to remain weak and prices to stay below USD1,600/t (annual basis) until 2022.

In **China**, pre-COVID we were anticipating supply to increase 4.4% in 2020, however, with both domestic and global demand impacted, we now expect China's aluminium output to register a smaller increase (+2%), before accelerating by 5.5% in 2021. We forecast a 2020-2024 CAGR of 2.9%. We estimate China demand to decline by 3.5% in 2020 followed by 3% recovery in 2021. This is supported by the economic outlook, with the view of HSBC economists expecting mainland China's GDP growth to be 2.4% in 2020 and recover to 7.5% in 2021.

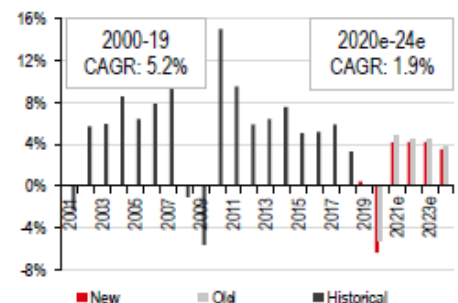
Outside of China, while we expect more production cuts in RoW (we forecast a 6.6% decline in 2020e), the supply response seems likely to leave the market with overcapacity, in light of the damage to demand. We see a need for aggressive cuts to RoW production to balance the market. High-cost smelters in the US, Australia, Africa and Europe are more prone to curtailments or shutdown. We expect RoW output to rise at a CAGR of 1.8% over 2020-24. This, compounded with slowing demand growth, should push the RoW market to a surplus this year from a deficit in the past several years. We expect the 2020 demand contraction to be at a rate of -10.1%, stemming from a higher impact of COVID-19 lockdowns and the aftermath, adding to the continued slowdown in all major consuming regions. However, we expect a pick-up in demand from next year onwards, leading to a modest demand growth CAGR of 1.4% over 2020-24 on the back of substitution.

3.6. Global Supply: to expand at a 2020-24e CAGR of 2.4%



Source: Wood Mackenzie, HSBC estimates

3.7. Global Demand: Lower growth factoring in COVID-19 demand destruction



Source: Wood Mackenzie, HSBC estimates

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Copper: Doctor, doctor, give me the news

Copper prices have been on a rollercoaster ride in 2020. In March, copper prices were down 25% year-to-date due to the outbreak of COVID-19 restricting economic activities around the world. However, prices rebounded in 2Q and are now up 9% y-t-d. The rebound in prices was led by a resumption in economic activity in China, as well as by the threat of supply disruptions in key producing countries, especially Chile and Peru.

Chinese demand for copper has been particularly robust, buoyed by a strong infrastructure push and stimulus measures. Governments in other parts of the world are gradually re-opening economies, and announcing stimulus measures as well as keeping liquidity high to kick start economic activity, which should be generally supportive of copper demand.

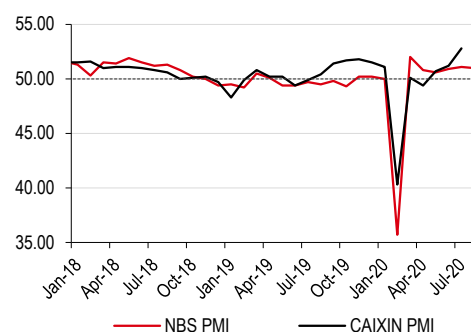
We estimate the copper market to be finely balanced in 2020 and acknowledge both upside and downside risks – higher than estimated supply disruptions could lead to a tighter market while a second wave (we are incorporating a disruption allowance of 5.5% for the year, higher than the historical average of 5%) or interruption in the re-opening of economies could lead to a deterioration in demand.

In the medium term, we expect a gradual recovery in global copper demand in 2021 and 2022, though not as robust as was witnessed in 2010 post the GFC. Overall, we expect global refined consumption to grow at a CAGR of 1.2% y-o-y over the next five years. Mine supply is expected to grow during 2021-24 due to recently committed projects and ramp-up of production (at Grasberg, Cobre Panama, Quellaveco, QB2, Spence, etc). However, there is a risk to the supply outlook as some of these projects were stopped due to the pandemic, which could keep the market tighter than our original expectations.

In the long term, more investment in projects will be required to meet incremental demand and expected depletions in the long term. We estimate that a copper price of USD3.00/lb is required to incentivise projects and bring enough supply to meet incremental demand and replenish the depletion of the existing mine supply in the long term. We recently increased our 2020 copper prices forecasts by 9%, but kept our 2021-2024 and LT copper price forecasts unchanged. Please see [Metals Quarterly Q3 2020: Metals prices making an about-face](#) (15 July 2020) for more details.

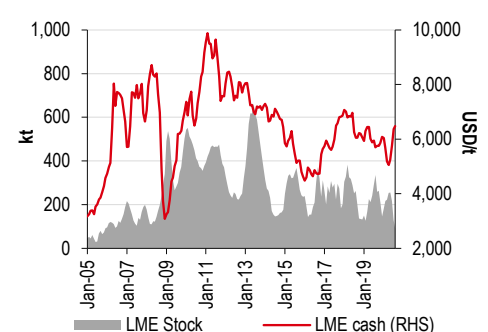
Copper price of USD3.00/lb is required to incentivise new projects to meet incremental demand

3.8. Manufacturing activities in China rebounded swiftly



Source: Refinitiv Datastream, HSBC

3.9. LME copper inventories at lowest level in the last 14 years



Source: Refinitiv Datastream, HSBC

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Nickel: Dislodged demand leaves nickel well supplied

The nickel price has climbed 38% after bottoming out in March and is +7% YTD. The price rally has defied our fundamental outlook for nickel, which we expect to remain in surplus due to weak demand and growing supply from existing and new projects in Indonesia.

Stainless steel (SS) accounts for c.70% of nickel demand. End-use demand of SS in appliances, construction and transport has been significantly impacted, however an expectation of an infrastructure led economic recovery has provided support to SS production in China. China accounts for c.55% (2019) of SS production, where we estimate a 5.3% contraction in production during 2020. We forecast China SS to recover from a low base and grow at 5.9% CAGR over 2021-24. This is based on strong infrastructure pick-up in China as forecast by HSBC economists.

Based on our expectation of a declining austenitic ratio and rising scrap usage, we forecast primary nickel demand from the SS segment in China to grow at just 1.5% CAGR over 2020-24. We forecast 7.6% y-o-y contraction in global stainless steel output during 2020 and expect a growth CAGR of 2.5% during 2020-24, which implies primary nickel demand growth of 1.7% pa in this segment over this time frame. With some positive support from non-stainless demand, we forecast primary nickel demand to grow at 3.4% pa over 2020-24.

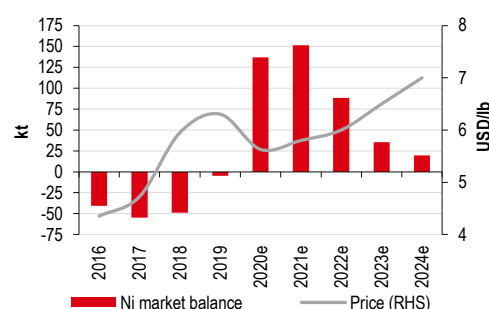
During Jan-May, China imported 1,558kt of ferronickel, recording a 94% y-o-y increase, with imports from Indonesia increasing 134%. Over the medium term, we expect supply from Indonesia to further increase as new and existing capacity ramps up, benefiting from lower unit costs and an abundance of nickel ore. We expect Indonesian nickel supply to grow at a CAGR of 18% over 2020-24, replacing capacity in China. As a result, we expect closures of smaller high-cost nickel pig iron (NPI) smelters in China. We forecast global nickel supply to remain flat during 2020 and grow at 3.6% CAGR over 2020-24. While class 2 nickel supply is expanding, higher quality class 1 nickel supply will likely continue to face shortages over the longer term as demand increases.

The two-tiered structure in the nickel market has taken a back seat due to lower than previously expected demand growth and sharp growth in class 2 nickel supply, which has reduced the class 1 nickel usage in SS and freed it up for premium usage (in EVs). We expect this 2-tier structure will regain dominance as the EV market picks up, boosting demand for class 1 nickel.

Supply ramp-up from Indonesia and a weaker demand has deferred the need for additional projects until 2024. We expect a surplus market over the next 3 years turning to a largely balanced market before the need for new projects re-emerges in the longer term. We forecast prices to average USD5.6/lb in 2020 and USD5.8/lb in 2021. Our long-term nickel price forecast is USD8.00/lb (in 2020 USD terms).

We expect nickel market to be in material surplus over next 3 years

3.10. Well supplied market due to lower demand



Source: Wood Mackenzie, HSBC estimates

3.11. Indonesia NPI exports to China is expected to further rise after the ban on ore exports



Source: Bloomberg, HSBC estimates. Note: January data not reported

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**Expect zinc markets to
 remain in surplus till 2023e,
 putting pressure on prices**

**Zinc supply has also been
 impacted by the pandemic,
 providing an element of
 fundamental support to
 zinc prices**

Zinc: Price recovery – more sentimental than fundamental

LME zinc prices have defied weak fundamentals, with a 38% recovery from the cUSD1800/t low hit on 24 March 2020 as ample liquidity led, weak USD and optimism around economic recovery has aided the metals sector including zinc. The commodity is now up 9% YTD, becoming the second best performing base metal in the LME complex (only 60bps behind Nickel).

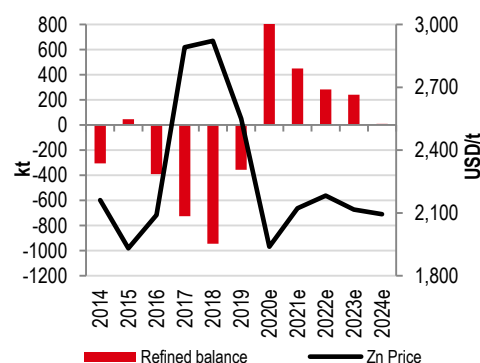
The price rise came despite contraction in zinc demand in major world economies – with the notable exception of China – as well as a sharp rise in LME stocks. Refined zinc inventories at LME are almost 340% higher than they were at the end of 2019. However, an element of fundamental support for the zinc price has been the 1.3mt of contained zinc (c10% of demand) production loss as a result of the combination of low zinc prices and COVID-19 induced containment measures in China, Peru, Mexico and Bolivia. Notwithstanding supply loss, we expect refined zinc market surplus to rise to 833kt in 2020e and remain in surplus till 2023e, on the back of higher supply and muted demand growth.

On the demand side, we expect global zinc consumption to decline by 7.1% in 2020e, as demand ex-China is forecasted to contract by c10%. With several countries outside China still struggling to curtail the COVID-19 spread, we believe the risks to demand estimates for RoW are skewed towards the downside. China has emerged as the bright spot for zinc consumption as economic resurgence from the COVID-19 induced downturn has been much faster than expected. While we forecast China demand to contract by 4% in 2020e, we believe there is an upside risk to our estimates. Signs of recovery in demand in China are visible, led by the thrust from government on zinc intensive “old infrastructure” such as power and transport. We thus expect China to perform significantly better than RoW.

On the supply side, as highlighted above suspension of mines and reduction in productivity due to coronavirus have resulted in significant production loss. A number of mines have announced closure or have been put on care and maintenance due to operational issues or poor market conditions (Caribou, Francisco Madero, Mungana King Vol, Namib, Santa Eulalia, Skorpion and Woodlawn). We forecast zinc mine output to contract by 6% y-o-y for 2020e.

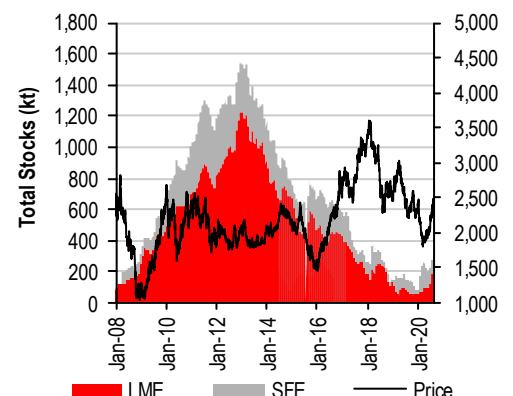
We believe zinc prices are likely to come under pressure as fundamentals catch up, making it difficult for zinc prices to trade above the USD2,200/t levels on a sustainable basis. We forecast zinc prices to contract by 24% y-o-y in 2020e to average USD1,939 followed by a 9% rise in 2021e to USD2,122/t.

3.12. Zinc markets to move into surplus from 2020e



Source: Wood Mackenzie, HSBC

3.13. Zinc price (USD/t) and inventory (LME and SHFE)



Source: Refinitiv Datastream, Bloomberg, HSBC

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Spot iron ore price have held up strongly above USD100/t for the last three months...

...but we think the current level is unsustainable and prices are near an inflection point

China's crude steel production has surprised to the upside, with y-t-d up 2.8% y-o-y

Brazilian supplies have started returning to the market and Vale has reiterated its FY20 guidance

Iron ore: At unsustainable highs

Iron ore prices have been trading above USD100/t since the beginning of June and over USD120/t since early August. Prices are up more than 50% from the 2020 trough in early February and +36% YTD, finding support from both better demand and lower supply thus far. Demand in 2020 has been much stronger than expected, led by better Chinese steel production, while H1 supply was disrupted on account of unfavourable weather, COVID-19 impact and slower than expected ramp-up in Vale production. We believe the current spot price of USD126/t is unsustainable with supply gradually improving and demand likely to slow in the coming quarters.

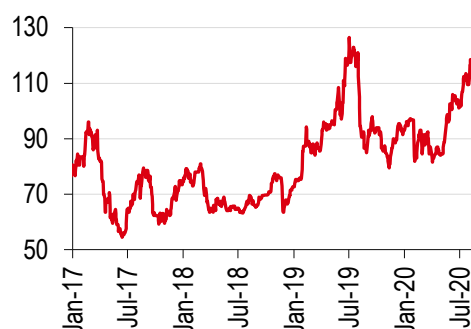
Chinese steel production has surprised to the upside year-to-date, increasing by 2.8% (July output was up 9% y-o-y), despite strong production last year and the COVID-19 impact in 2020. Steel mill utilization rates have increased by 9pp from the trough levels seen this year, while steel inventory at mills (13.9mt) and traders (15.4mt) have decreased meaningfully from the levels seen in March and are close to normalized levels. The combination of better production and lower inventories implies strong consumption, which is likely to be supported by fiscal and monetary easing. In addition, improved steel prices and increased profitability (helped by falling coal prices) for Chinese steel producers has led to stronger iron ore consumption, as evidenced by imports increasing 12% YTD, offsetting weaker consumption elsewhere.

Iron ore supplies were impacted in the first half of the year on unfavourable weather in Australia and Brazil in Q1 and then the impact of COVID-19 and related lockdown, combined with a slower than expected ramp up in production from Vale. However, the latest data showed that Brazil shipments have started increasing, up from their low levels seen earlier this year, with 34mt of iron ore exported in the month of July, the highest level since October 2019, which was 13% above the June shipments and at a similar level to July 2019. Vale has reiterated its 310mt iron ore production guidance for 2020, implying a +50mt H-o-H increase. Commodity producers such as Vale and BHP have also stated their views of moderating iron ore prices due to increased supply. According to the Pilbara Ports Authority, iron ore shipments from Australia's Port Hedland were 43.6mt, up 6% y-o-y, but down 16% m-o-m from June's record level of over 50mt. For more details, please see [Iron ore: Brazil's pain is once again iron ore's gain](#), 8 June 2020.

We expect the market to be in a small deficit this year, and turn into a small surplus starting 2021, though continued supply issues and/or better demand could easily push this into a deficit again. We remain cautious on the trend of iron ore, and expect weaker prices in 2H20. However, the risks to our average 2020e price of USD86/t and 2021e price of USD76/t are clearly to the upside at this point. We have a long term price forecast of USD65/t, based on marginal cost support. We believe China is a marginal cost producer with a unit cost of just above cUSD65/t (adjusted for value-in-use).

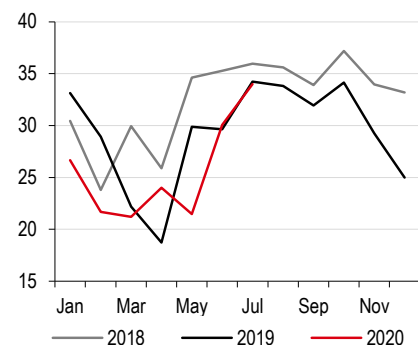
Please see [Metals Quarterly Q3 2020](#), 15 July 2020 for further details.

3.14. China spot iron ore fines 62% Fe CFR Tianjin port (USD/t)



Source: Refinitiv Datastream, HSBC

3.15. Brazil iron ore supplies have started recovering post a weak H1 (in mt)



Source: Wood Mackenzie, HSBC World Steel Model, HSBC estimates

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**Mainland China thermal coal
 prices recovered quickly over
 May-July...**

**... but seaborne prices have
 been languishing around
 USD50/t over the last five
 months**

Thermal coal: Diverging China-Seaborne prices

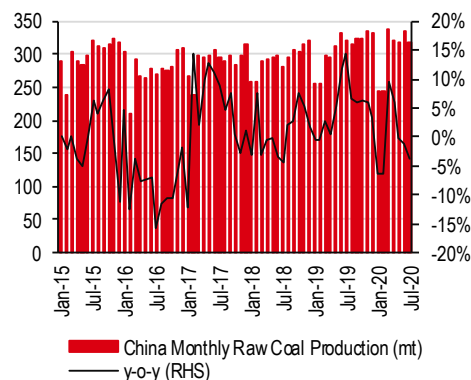
Following a COVID-19 driven price collapse in April, mainland China thermal coal (MCTC) prices rose c.25% from mid-April lows to c. RMB600/t in early July. A steady pick-up in domestic demand and various government supply interventions led to the quicker price recovery. However, as we wrote in [Metals Quarterly Q3 2020](#), 15 July 2020, we expect strong prices in 2H, but we did not expect prices to stay above the green zone (RMB530/t-570/t). As expected, spot prices retreated to c.RMB550/t over recent weeks on improved domestic supply and higher hydro power-generation.

While China's industrial activity began to recover from late March, other countries started grappling with COVID-19 outbreaks and experienced unprecedented disruption in economic activities. This led to a sudden drop in global seaborne thermal coal demand and seaborne (Australia Newcastle) prices plunged to USD50/t in Apr20 vs USD70/t in Jan20. While MCTC prices recovered quickly over May-July, seaborne prices have remained under pressure due to mainland China import restrictions combined with slow pace of ex-China demand recovery, and seaborne prices have been languishing around the same level over the last five months.

On coal trade, as China tightened the import restrictions since May, raw coal imports fell by -16% y-o-y over May-July vs +27% over Jan-Apr. We believe import controls will continue to serve as a means of stabilizing coal prices and protecting the local market. Many countries have started easing COVID-19 restrictions in phases since June, but the economic recovery has been tepid and coal demand is subdued. In our view, seaborne demand recovery will be gradual and limited this year. We estimate global seaborne thermal coal demand to drop c.9% y-o-y in 2020.

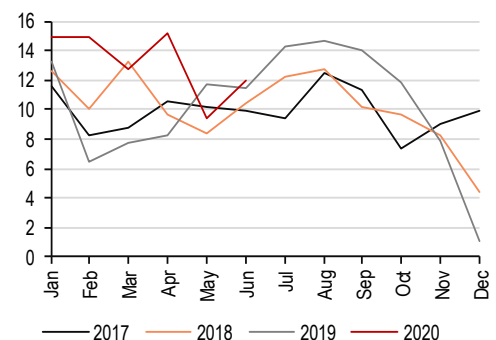
We expect relatively strong mainland China thermal coal demand in 2H20 on the back of a pick-up in industrial activity, and believe China will continue to undertake actions that will keep domestic prices within the target green zone. In contrast, we see seaborne thermal coal prices as likely to remain under pressure in the near term. Our price assumptions for mainland China and Australia thermal coal prices are RMB550/t and USD60/t, respectively, in 2020e and RMB535/t and USD72/t respectively long term (2020 real terms).

3.16. China's raw coal production monthly (mt)



Source: SXcoal, NBS, HSBC

3.17. China's thermal coal imports (mt)



Source: IHS Markit, HSBC

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**Extended lockdowns in
 various countries (ex-China)
 due to COVID-19 eroded
 seaborne met coal demand**

**We expect a gradual pick-up
 in prices**

Met coal: Slower recovery in H2

Mainland China met coal demand has been very strong in 2020, backed by strong crude steel production. The COVID-19 outbreak in Q1 didn't affect Chinese steel production as steel making is a continuous process, and shutdowns/restarts are expensive last resorts. Moreover, China's industrial activity began to recover from late March and the aggregate crude steel production over first seven months of the year is up 3.0% y-o-y.

In contrast, other geographies started to grapple with COVID-19 outbreaks from March and extended lockdowns in various countries (ex-China) eroded met coal demand and altered the seaborne S/D balance. Hard coking coal (HCC) prices plunged to c.USD110/t in late April (vs USD160/t in March), and since then, prices have been hovering around the same level.

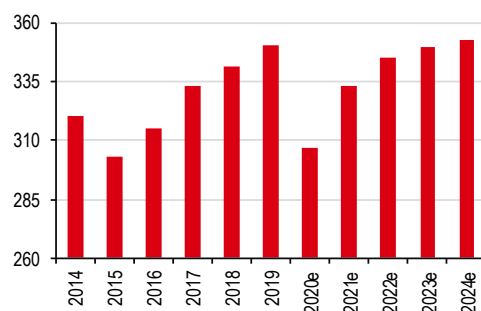
The closure of automotive plants and lower levels of construction activity resulted in a contraction of ex-China steel demand. In April-July, crude steel production by major met coal importers fell sharply, significantly reducing demand for seaborne met coal.

Crude steel production has been lower y-o-y across markets during the period: 1) India fell 38%, 2) Japan 30%, 3) Europe 25%, and 4) Korea by less at 13%. However, we expect a gradual pick-up in ex-China demand in the months ahead, as the lockdown restrictions have been easing since June and industrial activities are slowly picking up.

In our view, supply curtailments may be required to rebalance supply-demand conditions. Despite the lower prices, except for a few accidental stoppages, no major supply cuts are announced. But we expect deliberate supply cuts if the current depressed price levels persist for longer, as HCC prices are below the marginal cost of supply (Wood Mackenzie estimate of USD130/t).

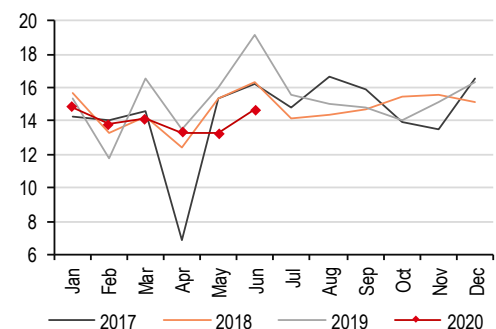
Largely, we expect a gradual improvement in met coal prices through coming quarters and better S/D balance conditions, but broadly there are more constraining factors including weak macro-economic conditions, poor ex-China demand and uncertain China import policies. Our HCC quarterly contract price average assumption is USD136/t in 2020; and our long term price assumption is USD130/t (2020 real).

3.18. Global met coal imports (mt)



Source: IHS Markit, Wood Mackenzie, HSBC estimates

3.19. Australia met coal exports monthly (mt)



Source: IHS Markit, HSBC

4. Precious metals: Outperformers, but less of a rush from here

- ◆ Gold is well supported by monetary and fiscal stimulus but eroding physical demand and limits to falling yields may curb prices
- ◆ Silver gained sharply on higher gold but reduced industrial and jewellery demand may lead to a surplus and help weigh on prices
- ◆ Platinum rallies appear dependent on gold strength as underlying demand is sluggish; palladium has much tighter fundamentals

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Gold rush

After rallying by 18% in 2019, gold is up a further 30% for the year to end-August. While gains in 2019 are proof that gold was already in a well-entrenched bull market before the pandemic, prices have rallied further, a direct and indirect beneficiary of the crisis and investors' response to economic uncertainty.

Much of the rationale that we presented for higher prices in [Gold Update: Riding the liquidity wave higher](#) (7 July 2020) remains intact and is reaffirmed by our more recent report entitled [Gold and silver update: After the gold rush](#) (14 Sep 2020).

Gold has been in high demand as an investor 'safe haven'

The emergence of COVID-19 has dramatically altered the global economy, unhinging financial markets, disrupting trade and investment, raising unemployment, straining international relations and impacting commodities. The consequences have been positive for gold, energizing demand for bullion as investors seek it for its safe haven qualities.

Even if further gains are hard to come by, we believe gold will remain supported by the ongoing fallout from the pandemic. The perceived need for a 'safe haven' even in the event of further relaxation of the lockdowns and equity gains and some level of economic recovery is likely to keep gold supported for the balance of this year and the next.

Twin bulls: monetary & fiscal policies highly supportive

Accommodative monetary policy and rising debt levels are gold supportive

Historically gold responds positively to accommodative monetary policies and to rising debt levels. The unprecedented simultaneous peacetime monetary *and* fiscal response to the economic and social dislocations of the pandemic is decidedly gold-bullish. This provides gold with two important ingredients for high prices: debt and liquidity. Low interest rates in real and nominal terms (and negative rates in some economies), expanding central bank balance sheets, central bank intervention in the economy and huge fiscal packages are all individually gold-friendly but taken together are decidedly bullish.

The long-term consequences of these measures are as of yet unknown. But the escalation in debt combined with highly accommodative monetary policies has made gold attractive.

HSBC expects 'lower for longer' interest rates

- ◆ HSBC's Head of Fixed Income research Steven Major maintains a year-end forecast of 0.5% for the US 10-year Treasury. Forward guidance and the threat of yield curve control put a lid on yields, says Mr. Major and he retains his "lower for longer" outlook for US rates based on the need for ongoing accommodation.
- ◆ The Fed's recent framework policy shift announced by Fed Chairman Jerome Powell at Jackson Hole in which the Fed will seek a moderate overshoot of 2% inflation in the current cycle helps justify the lower for longer outlook for yields.
- ◆ HSBC's US economist Ryan Wang said he expects the federal funds target range to be held steady at 0-0.25% through at least the end of 2021.
- ◆ In June, FOMC participants were nearly unanimous in projecting an unchanged federal funds rate through the end of 2022. By sending a strong signal about its intentions, the Committee may have reduced the need to provide a specific date-based or outcome-based commitment to unchanged policy rates.
- ◆ What is more, monetary easing is a global trend, with some central banks embarking on negative rates to jumpstart the economy. Central banks such as the ECB are likely to maintain highly accommodative policies with negative yields persisting in the Europe.

This global easing trend is gold friendly. It is widely accepted that US Treasuries and gold represent two of the world's traditional and most reliable risk-off assets. High global levels of negatively yielding sovereign debt leads us to expect that even if gold prices pull back, they will find support.

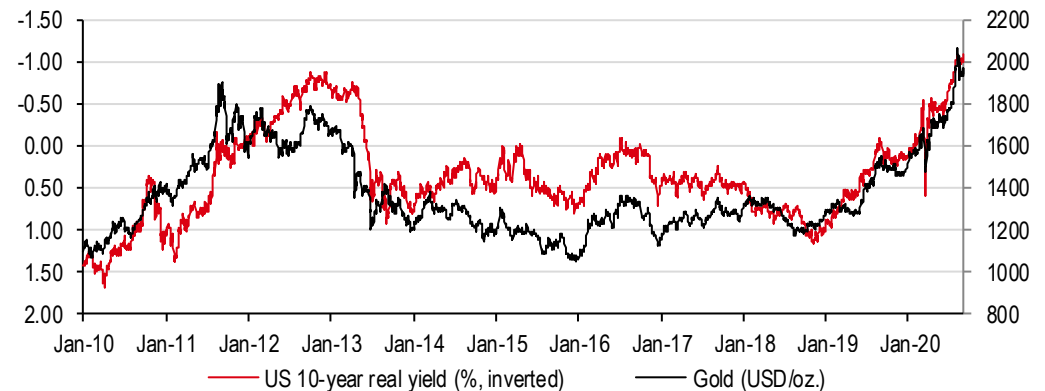
At the same time, the impact of COVID-19 is raising fiscal spending. High unemployment and limits to monetary policy require more fiscal spending. Infrastructure spending in a host of nations will help drive up debt-to-GDP ratios globally, in many nations to levels not seen since WW2. Traditionally high and rising government debt is gold supportive.

Yielding higher

Low or negative real yields are supporting gold prices

Low or negative real interest rates are key to propelling gold higher (Chart 4.1). When US real yields are low or negative, investors have no opportunity cost in owning bullion. Also, negative real US yields are a likely indicator of financial or economic stress. This will tend to boost the safe haven demand for gold. Furthermore when US real yields turn negative it may be negative for the USD, which will boost gold in USD terms. The relationship is quite clear. If nominal yields fall to Steven Major's year-end forecast of 0.5% for the US 10-year Treasury and remain low, we can expect gold to be well supported.

4.1. Inverted US real yields and gold



Source: Bloomberg, HSBC

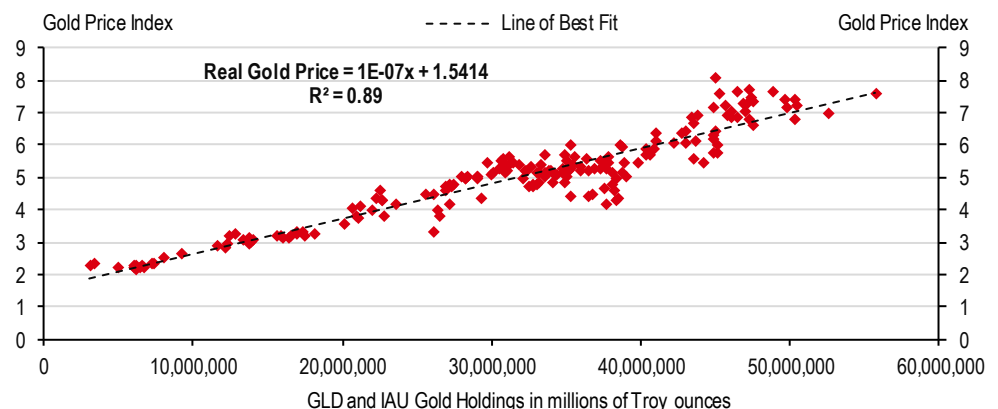
Investor demand rockets

Nowhere is the increase in investor demand for gold more visible than in the surge in gold-Exchange Traded Fund (ETF) demand. It is clear that the increase in gold-ETF demand has been significant in aiding gold prices higher (Chart 4.2).

Gold exchange traded fund demand has been strong

At the end of 2019, ETF holdings stood at 81.46moz, a rise of 10moz last year. Holdings now stand at a record 109.42moz. This is equivalent to annual gold mine production. ETF demand has also tended to increase with global equities as investors look to hedge equity positions, we believe. Monetary and fiscal policies globally are expected to support further offtake. Even assuming a flattening in demand, the increase will be substantial this year. This level of demand is unlikely to be sustained, however, and we look for the rate of offtake to ease in 2021.

4.2. The gold price is highly positively correlated with ETF holdings



Source: Bloomberg, HSBC

The success of the ETFs may explain some of the decline in physical bar demand as in some cases investors have a similar profile. However, ETF demand can be fickle, and earlier in the decade ETFs experienced substantial liquidation. This could happen in the case of a prolonged equity decline which could raise investor demand for cash. After hitting record net long positions of 38moz on the Comex earlier this year, net longs have eased. However, net speculative long positions are still historically high at 27.7moz as of writing. We expect the market to retain a healthy level of net longs for the remainder of 2020, although we could see a build in speculative short positions. Our rationale for expecting high net long positions is similar to our logic for high ETF positions.

Trade and geopolitics supportive

Gold is the focus of 'safe haven' demand. Elevated trade and geopolitical risks, many of which appear to have risen this year, have funnelled funds into gold.

There is historical evidence to show that low or contracting trade flows tend to be accompanied by rising gold prices, albeit with a lag. Trade risks appear to be playing a role in a slowing global economy. Data from Bloomberg show trade flows contracted notably for much of the year.

Rising geopolitical risk is good for gold

Geopolitical risk is gold positive. The US presidential elections inject some level of political uncertainty which may stimulate gold demand closer to November. The run-up to the last presidential election saw a massive rise in US gold and silver coin purchases. The pandemic has also raised geopolitical tensions. The longer-term impacts for each country on the relationship between the public and private sectors, on existing tensions in the political system, on growth and currencies, and on sovereign debt, will be profound and as trade weakens and economic recovery looks uncertain, geopolitical tensions tend to rise. While periodically these risks ease, a certain level of risk remains intact, to the benefit of gold.

Not getting physical

Underlying physical demand for gold – about half of which is usually absorbed by the jewellery market – is an important, if sometimes little discussed, component of the market. Underlying physical demand at the retail level has weakened as a result of the price rally.

Physical demand has weakened due to the gold price rise

The World Gold Council in its recent *Q2 Demand Trends* showed a sharp increase in investment demand, offset by a decline in jewellery and other physical demand. The report stated that overall Q2 gold demand was down 11% y-o-y to 1,015.7t and demand for the first half year was 6% weaker at 2,076t. The decline was due heavily to the impact of COVID-19 and high prices on jewellery demand.

Total bar and coin investment weakened sharply in Q2, leading to a 17% y-o-y decline in H1 demand to 396.7t. But Western demand for bars and coins was very high, while price sensitive Eastern demand weakened. H1 jewellery demand slumped a massive 46% y-o-y to 572t as markets remained in lockdown and consumers, especially in price sensitive emerging markets – where the bulk of physical bullion is bought – were greatly deterred by the high price and falling disposable incomes.

In addition to USD price gains, EM currencies have tended to weaken against the USD, at least until recently. This boosts gold prices even further in price-sensitive EM economies, thus eroding demand. In some nations, officially managed import quotas may also restrain import levels. Declines across the emerging world, particularly among the giant consumers of India and China, are significant.

Mainland China and India have had weak gold imports

Weakness is also illustrated by low imports into mainland China and India, two countries that between them account for nearly two-thirds of global physical demand. China can attract the equivalent of as much as 40% of global mine production in imports in normal years. According to official customs data neither India nor China registered any meaningful net imports from April right through to July, although Indian imports picked up in August.

Technology demand also fell. Central bank buying slowed again in Q2, and totalled 233t for 1H, as central banks conserved foreign exchange. The decline in oil prices is limiting official sector purchases from Russia and Kazakhstan and impacting sovereign wealth fund demand from oil-exporting nations. This nearly eliminates an important component of demand.

Gold supply has been disrupted by the COVID-19 pandemic

Gold supply was also impacted by the pandemic, falling 6% to 2,192t as both mine production and recycling were affected by lockdown restrictions. Gold production is likely to be curbed this year by the impact of the pandemic.

However, high prices have triggered a boost to recycling. Jewellery demand may make a modest recovery and the drop in mine supply may not be important due to the high levels of aboveground stocks. Also any supply deficit from production will likely be offset by increased recycling. The massive reduction in jewellery demand and imports into key consumer nations has so far been absorbed by ETF and other forms of investor demand. However, should investor demand, notably Western investment demand, stall, gold prices could correct until EM buying puts a floor on prices.

Silver streak as the metal plays catch-up to gold

Silver prices have been volatile this year, plunging in February and March to a low of USD11.60/oz as investors liquidated holdings to meet margin calls as equities cascaded lower. The initial sell-off was triggered by concerns over global economic growth due to the lengthy lockdowns in most key economies. And even though silver prices moved higher in the following months, they remained weak compared to gold. As gold prices surged from March onwards silver was left behind. This was largely because gold captured investors' attention, while silver was hamstrung by weak industrial demand jewellery demand. The result was a widening of the gold/silver ratio to historic highs of 1:124 (Chart 4.3).

The gold-to-silver price ratio reached an all-time high in March ...

4.3. The gold-to-silver price ratio rose to an historic high in March, before falling



Source: Refinitiv Datastream, HSBC

The sharp rise in the gold-to-silver price ratio also helps to explain the more recent silver price rally. Silver benefited from investors who had either not participated in the gold rally or were reluctant to commit more funds as gold surged above USD2,000/oz. Investors turned to silver and prices soared to USD29/oz, driving the gold/silver ratio back below 1:70 recently.

... before a strong rally in silver prices pushed the ratio lower again

This dichotomy is likely to continue, with silver exhibiting industrial and precious metal tendencies at different times. Investment demand jumped recently. However, the market displayed signs of being overbought as it neared USD30/oz. The gains in the silver-ETFs and CME long positions reflect investor demand, but underlying industrial offtake is modest at best, we believe. Combined net long and ETF positions currently equal 1.149bnozt, the equivalent of a third more than annual mine output and a shade away from the record of 1.15bnozt set in March 2019, when prices were considerably lower. Also, in our view, the surge in silver prices no longer makes it attractive compared to gold.

Silver prices are likely to remain volatile

Silver is likely to remain volatile. As central banks intervened heavily and governments announced hefty fiscal stimulus packages, global sentiment saw a visible improvement. Increased industrial activity is aiding some forms of silver demand. But demand is below 2019

levels. Restrained consumer spending is limiting jewellery demand although lower priced silver may be gaining on more expensive gold jewellery. Mine supply has been negatively impacted by COVID-19 shutdowns and recent price rallies have stimulated recycling. Small bar and coin demand is recovering, however, from low levels last year and may rise considerably as we near the US elections, in a similar pattern to 2016.

On balance, we see the market moving to a narrower deficit in 2021. But above-ground stocks are more than ample to finance any deficit. After starting the year off at 606moz, ETFs now hold 890moz. Industrial and jewellery demand should also recover later this year and in 2021, but prices are high relative to gold and do not offer the “good value” for investors they did earlier in the summer. This may weigh on prices.

Platinum group metals: mixed “metal-phors”

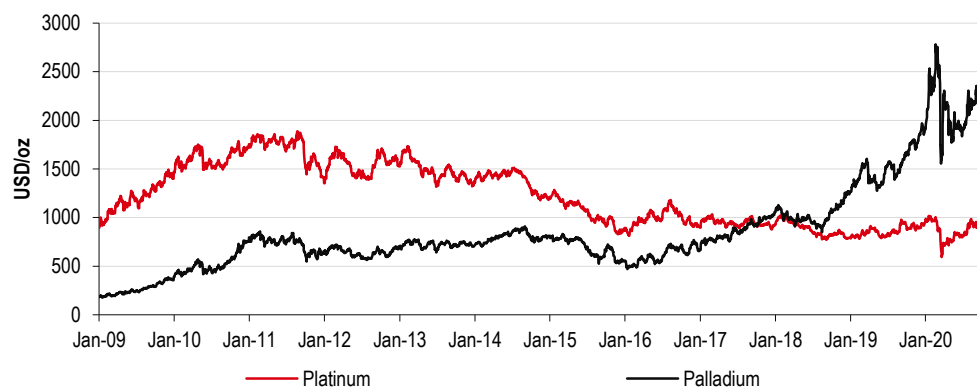
Although closely related, platinum and palladium have sharply differing underlying fundamentals and price paths.

Platinum was affected by COVID-19 on the demand and supply side

Like other metals platinum has been greatly affected by the COVID-19 pandemic. Platinum prices plunged 45% from YTD highs of USD1,041/oz to USD558/oz in March as investors liquidated in reaction to pandemic-related equity declines. Demand has been hit on all sides. Auto, industrial and jewellery demand are down and despite the recent notable improvement in auto sales, are likely to stay historically weak as economies struggle to recover.

COVID-19 related mine shutdowns in South Africa have impacted supply. Refined supply has also been impacted as consumers hold onto older vehicles for longer than usual. On balance we forecast that platinum will run modest supply/demand surpluses this year and next which will curb rallies.

4.4. Platinum vs Palladium price



Source: Refinitiv Datastream, HSBC

Although down sharply from a high on 27 February of USD2,866/oz, palladium prices are still markedly higher than gold prices. They have also recovered from liquidation brought on by pandemic-related slide in equities when prices fell to USD1,481/oz, a low for the year so far, in March.

The palladium market was also heavily affected, although price remains around historical highs

By contrast with platinum, the palladium market is in a long-running structural supply/demand deficit, but the impact of the coronavirus, while curbing mine output, has also derailed auto demand and with it palladium consumption. Additionally, we expect much lower levels of recycled supply from the auto industry. That said, while the size of the deficit may vary, we see little likelihood that the market will run a surplus any time in the next several years. But the deficit is narrowing this year from 2019.

Demand ‘car-nage’

The global auto industry has been especially hard hit by the coronavirus pandemic. Sales and output are down in the face of contracting economic growth, soaring unemployment and falling incomes, which affects auto demand. In addition, massive swathes of global production and assembly plants were closed earlier in the year for health concerns. The worst appears over however. Light vehicles sales in the world’s largest auto market, China, have improved in recent months. The European and US markets, which account for between a fifth and quarter of global demand, have shown a continued improvement, with both bottoming in April. We see limited room improvement for the rest of the year and greater demand in 2021.

Sharply weak demand for motor vehicles has weighed on PGM prices

In their latest report, HSBC’s Autos research team lowered their global light vehicle production estimates to a fall of 20% in 2020 to just 71.06m vehicles, followed by an increase of 12.4% in 2021 to 78.84m vehicles. Even assuming a recovery in 2021, the team estimates that output would be 10m units below the pre-COVID-19 level of 88.86m units. These forecasts are close to revised IHS market forecasts for August for a 20% y-o-y decline in LDV sales for CY20 (previously 23% y-o-y decline) and a 13% y-o-y recovery in LDV sales in 2021. This is an indication of an improved auto market outlook as a result of a faster than anticipated recovery post COVID-19 lockdowns, but still sharply lower demand nonetheless. Global production is unlikely to reach the 2019 level until 2023 at the earliest and possibly 2024.

Platinum has been almost totally excluded from the production of autocatalysts for gasoline-driven vehicles. Diesel vehicles still have heavier platinum loadings, and continue to be at threat of losing market share to near-platinum-free gasoline vehicles. Demand may be aided by tighter emissions regulations, notably in mainland China where China’s 6b regulations are increasing platinum loadings per vehicle. In [PGM Update: The COVID-19 balancing act](#) (14 July 2020) we stated that based on this, we expect platinum auto demand may fall to 2.223moz in 2020, down from our previous forecast of 2.444moz. Assuming some recovery, we keep our 2021 forecast unchanged at 2.699moz. The auto industry accounts for around half of physical demand.

Key questions surround possible substitution from palladium to platinum

The locus of palladium demand is the auto sector with more than 80% of physical end-use going to the auto industry. Although the most recent sales figures for gasoline autos show some recovery, demand will be down on last year. Of the three massive auto markets, Western Europe, China and the US, China and the US are primarily gasoline driven and gasoline even accounts for a good share of the European auto market. Gasoline vehicles require heavy palladium loadings. Based in large part on HSBC’s auto production forecasts, we forecast auto demand for palladium of 7.524moz for 2020 and 8.85moz for 2021. But without further economic recovery, it will be hard for auto demand to increase markedly going forward. Even assuming a recovery, palladium auto demand will likely be well below the pre-COVID-19 levels.

A question in the market is whether the still high prices for palladium will lead to substitution with platinum. This has so far not occurred to any noticeable degree although BASF and Sibanye said in February that they have devoted resources to research on the issue. Also the implementation of China’s 6b regulations raises palladium catalyst loadings in those cars that are produced or sold into China.

Other types of industrial demand for both platinum and palladium will generally be down this year, including glass, chemicals and petroleum, due to the likelihood of weaker industrial production as forecast by the HSBC economics team with only a mild bounce expected in 2021. Net platinum jewelry demand is about the same size as net autocatalyst demand but is often little discussed. Platinum jewelry offtake has fallen for five straight years, notably in China where the bulk of platinum jewelry is consumed. Demand looks to be even weaker in 2020. This is not only a function of COVID-19's impact on China's consumers, but also given the labor intensive nature of platinum jewelry, which reduces merchants' margins.

Low prices have also not been fully reflected in retail prices. Moreover, platinum's high-end consumer appeal has fallen with lower prices. We expect jewellery demand this year to be weak but look for improvement in 2021, as we believe there is a floor for demand for those who prefer platinum jewelry. Also as we believe platinum is attracting some demand from high prices gold.

The impact of COVID-19 is curtailing both primary and secondary platinum supply

The impact of the COVID-19 pandemic is resulting in profound changes in PGM supply and demand balances that will likely stretch through 2021 and beyond. On the supply side, the pandemic is curtailing both primary and secondary platinum production. Mine supply is down this year due to temporary – but severe – shutdowns at mining operations.

COVID-19 is weighing on PGM supply

South Africa accounts for the bulk of global platinum output and holds the majority of the world's reserves. It is the second largest palladium producer after Russia, where it is generally mined as a by-product with nickel. The locus of these shut-ins is South Africa – the world's largest platinum producer.

The latest production data out of South Africa showed July PGM production increased 4.6% y-o-y and is up a whopping 66% m-o-m. Output seems to be normalizing after COVID-19 disruptions. But implied PGM exports volume for July decreased 30% m-o-m after posting a m-o-m recovery during in May-June. PGM exports are still 17% lower y-o-y. YTD platinum and palladium exports have declined 12% and 22% y-o-y, respectively. So global markets are still theoretically on the tight side for PGMs. Producers are recovering from COVID-19 mandated shut-ins in April. Mechanised operations have ramped up rapidly to full capacity post COVID-19-related stoppages, however the conventional mines seem delayed.

According to producers, nearly 95% of South Africa's economy was allowed to open up when the country moved to Level 3 lockdown restrictions in June. Mine lockdowns and government mandated closures, which commenced on 26 March, have notably reduced output. South Africa entered lockdown Level 3 on 1 June, allowing mines to resume full operations, following some nine weeks of restriction.

Risks persist and our South African economists still view the economy as weak but from a mining perspective, the industry is trying to bounce back from the COVID-19 induced lockdowns. South African supply will also be affected by a prolonged outage at Anglo American Platinum's converter plant (ACP). Anglo declared a force majeure on 6 March, following an explosion at its Phase A converter plant in February, and technical problems during the ramp-up of the standby Phase B unit. Anglo closed its Phase B unit of the ACP again in June in Rustenburg after a water leak in the high-pressure cooling section of the plant. However, not all is negative for South African output.

Producers are benefiting from a weak ZAR and a strong basket price due to high palladium, rhodium and gold prices. Eskom, the state utility, has revised its winter load shedding to a more optimistic forecast. The lockdowns have allowed for plant maintenance and winter load shedding that does not impact producers.

Russian PGM output this year may be slightly lower than last year but little changed in 2021 and next may be little changed. The dip is mostly due to reduced inventory available for sales and the impact of planned smelter maintenance at Nor Nickel. Zimbabwe has the second-largest platinum reserves after South Africa but is unlikely to see big changes in output. Zimbabwe may maintain output despite the COVID-19 crisis. Although the bulk of palladium mine supply is split between South Africa and Russia, palladium production is likely to be less affected by the decline in South African PGM output due to more diversified supply sources for palladium outside South Africa.

Secondary supply is also down as the collection and refining of platinum scrap for recycling is also disrupted by the pandemic. The demand for autos plunged as the global economy contracted this year, unemployment rocketed and incomes fell, resulting in sliding auto sales, which quickly translated into sharply reduced vehicle production.

Changing patterns in platinum investment

After rising by more than 1.1moz in 2019, led by ETF purchases, there was a shift in investor interest to platinum bars. Low prices in Q1 in JPY terms triggered heavy Japanese purchases of 313,000oz, according to the World Platinum Investment Council. ETF holdings ended 2019 at 3.31moz and after falling 260,000oz in the aftermath of the stock market rout in March have risen to 3.62moz. The World Platinum Investment Council has also reported an increase in 2Q bar and coin demand. Much of our logic for better investment demand is linked to our view for firm gold prices as we forecast in [Gold Update: Riding the liquidity wave higher](#) (7 July 2020), and again in our more recent [Gold and silver update: After the gold rush](#) (14 September 2020) which may aid platinum prices. Net long positions on the CME stand at 1.35moz.

Investment liquidation but little left to give for palladium

For many years earlier in this decade and the previous one, the size of palladium production-consumption deficits did not seem to matter as ample above-ground stocks, mostly in Russia, handily financed the deficit and plugged the gap. Later, investor liquidation filled the gap, mostly from the ETFs. This changed in 2019. There was little investor liquidation in 2019, and palladium prices rose as the production/deficit widened.

Palladium-ETF investors liquidated heavily in March falling 173,000oz year-to-date. They have since recovered to 500,000oz. This leads us to believe that we are likely to see little more liquidation from this source. This is potentially bullish, but the much narrower deficit we project for this year takes significant upside off prices and helps to explain our view that prices may move closer to USD2,000/oz near term. The palladium net speculative position has declined 1moz since the start of the year and is currently at 371,000oz.

A wider deficit in 2021 with little supply likely to come from the ETFs explains our view that prices will be firm in 2021. The market will have to rely again on above-ground stocks to finance the deficit. Consequently, we expect further draws on existing above-ground stocks, which have fallen by more than 5.7moz since 2012. Net long positions on the CME are a moderate 350,000oz as of writing with plenty of room to increase.

The swing to platinum surpluses

Based in large part on data from Johnson Matthey's (JM) PGM market report for 2020 (May 2020), the platinum market registered a modest deficit of 227,000oz in 2019. That the market was able to run a deficit – despite deteriorating auto and jewelry consumption – was largely due to a massive increase in investor offtake totalling 1.1moz, funnelled principally – though not exclusively – through the ETFs. Without this investment, the market would have been in surplus by more than half a million ounces, on our calculations.

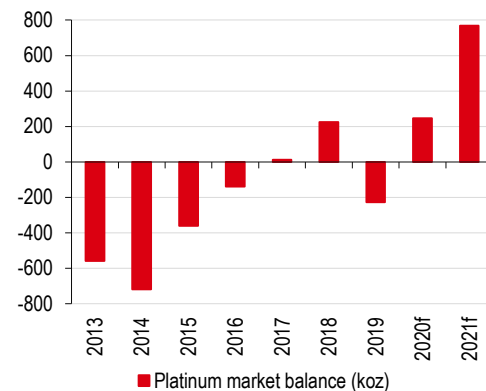
Based on reduced auto demand and mine supply, as well lower recycling and moderate investment, we look for the market to move back into surplus this and next year by 247,000oz

Platinum investment demand is supported by high gold investor demand

Palladium ETF holdings have fallen to levels where they may not be able to plug deficits

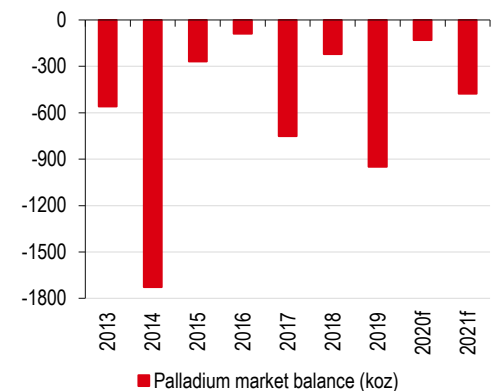
We look for platinum to move into surplus this year and next

4.5. Platinum market balance



Source: Johnson Matthey, WPIC, HSBC

4.6. Palladium market balance



Source: Johnson Matthey, WPIC, HSBC

and a greater 769,000oz respectively. This should limit gains but we believe platinum will receive underlying support from firm gold.

A smaller to a bigger deficit for palladium

The palladium market is in a long-running structural supply/demand deficit, but the impact of the coronavirus, while curbing mine output, has impacted auto sales and production more seriously, derailing palladium consumption. Consequently, we forecast a narrower deficit this year from 2019. According to our supply/demand model based heavily on Johnson Matthey's PGM Review 2019 (May 2020), palladium ran a deficit of 950,000oz last year. Much of this was due to a massive 800,000oz increase in auto demand and the unlike previous years of investment, ETFs did not contribute greatly to supply.

We forecast a narrowing of palladium's supply/demand deficit to just 129,000oz this year followed by a widening to 476,000oz in 2021. Our projections for deficits are lower due to a steep contraction auto demand, which accounts for the bulk of palladium consumption. Auto demand will largely, but not wholly recover next year, we believe and the deficit will widen, despite an increase mine supply. A narrower deficit takes any significant upward pressure off prices at least for this year, and prices may ease closer to USD2,000/oz, but we expect stronger prices in 2021 given our expectation for a wider deficit.

Conclusion

The COVID-19 pandemic has resulted in massive changes to PGM demand, most notably via lower auto production and other forms of industrial demand. Supply has also been heavily impacted with curbed mine output and decreased auto scrap supplies.

Platinum demand is further curbed by reductions in platinum jewellery purchases, notably in China. Investment is firm. The result is likely to be a swing in supply/demand balances for platinum from a deficit last year to a small surplus this year, followed by a wider surplus in 2021. For palladium, the large deficit of 2019 will likely narrow very considerably in 2020 but increase in 2021.

Platinum has seen a marked recovery in bar and coin demand, which is helping to offset less robust but still good, ETF demand. Firm gold prices may encourage platinum investor demand. But less than compelling fundamentals may ease prices back below USD900/oz. Palladium prices have fallen sharply from record highs earlier this year and may be more stable as previously acute demand concerns and lack of available material ease. Prices may ease closer to USD2,000/oz. But a wider deficit in 2021 should support prices. We leave our average price forecasts for both metals unchanged. Better demand and a wider deficit should support palladium prices in 2021 while we expect firm gold to be key in supporting platinum despite our forecast of a wider surplus.

Deficit of palladium has decreased, but is expected to widen

Palladium prices are set to remain underpinned by demand/supply deficits

5. Battery-related materials: Electric vehicle tipping point

- ◆ The expanding climate change policy agenda is driving increasing mandates for electric vehicle usage ...
- ◆ ... and a re-tooling by motor vehicle manufacturers away from combustion engines and towards electric vehicles
- ◆ Demand for battery and electrification-related materials, such as lithium, cobalt, copper and nickel is set to be supported

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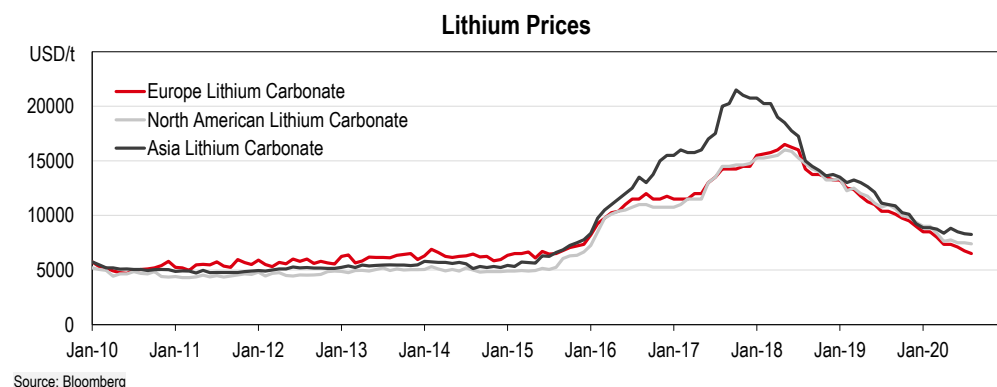
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Short run weakness ... but the future looks electric

An immediate effect of the COVID-19 shock has been to sharply weaken production of motor vehicles, which has seen a further fall in the prices of the battery-related materials lithium and cobalt, which were already oversupplied (Chart 5.1). As we have described in previous Global Commodities reports, the battery-related materials have been through a 'super-cycle' over recent years, with new investment in capacity finally catching up to demand from 2018 onwards, pushing prices significantly lower (see [Global Commodities: Better ... but it ain't a 'super-cycle'](#), 8 March 2018). In the short run, the risk of further waves of COVID-19 disruptions has kept uncertainty high and lithium and cobalt prices low, as described further below.

5.1. Lithium prices have fallen further in response to COVID-19



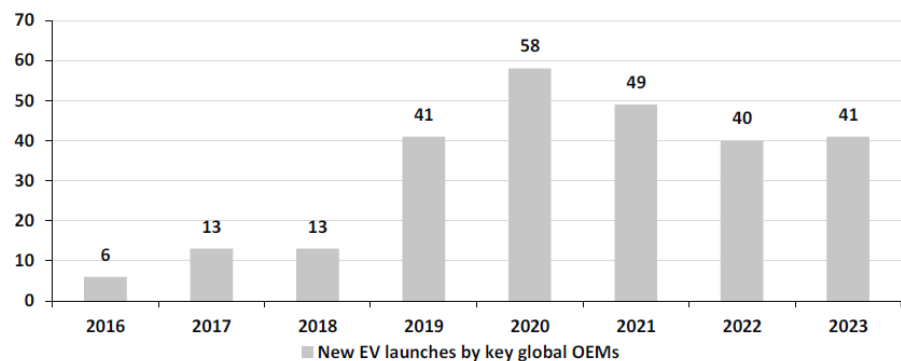
However, we maintain our long-term bullish outlook for lithium, driven primarily by expected growth in demand for electric vehicles. Indeed, one of the expected beneficiaries of the changing climate policy is expected to be the commodities that underpin the shift to greater use of electric vehicles and battery storage. This includes metals such as copper and nickel, as well as the battery-related materials, such as lithium and cobalt.

Electric vehicle model launches are accelerating ...

Electric vehicle adoption could be at a 'tipping point'

HSBC's Autos equity research team argue that electric vehicles are on the cusp of a 'tipping point' for market share (see [Electric Vehicles: Global EV progress – Tipping point](#), 27 August 2020). The pace of growth in new electric vehicle models has accelerated, and many new models are coming. Global EV adoption could be at a tipping point as 150 new launches are lined up over the next three years (Chart 5.2). For example, last year, VW Group announced that under its revised electrification plan it would launch about 70 new EV models over the next decade, up from 50.

5.2. The pace of new electric vehicle model launches is accelerating



Source: HSBC, HIS Global. Please note some of the launches in 2020 may get delayed into 2021 due to the impact of COVID19. Key OEMs considered – Audi, BMW, BYD, Chevrolet, Citroen, Ford, GM, Great Wall, Honda, Hyundai, Jaguar, Land Rover, Jeep, Kia, Mercedes Benz, Nio, Nissan, Peugeot, Porsche, Renault, Skoda, Tesla, Toyota, VW and Volvo

... much of which is underpinned by government mandates and targets for electric vehicle market penetration

Much of this shift to electric vehicles has been underpinned by government policy and targets for electric vehicle market penetration (Table 5.3). In the past six months, several countries in the EU have announced additional subsidies with a clear focus on promoting battery electric vehicle (BEV) and plug-in hybrid electric vehicle (PHEV) demand, while the all-important Chinese market should benefit from its new energy vehicle (NEV) subsidies extended by two years until 2022.

5.3. The major markets have significant targets for electric vehicle market penetration

Electric car deployment target	Target	Target year
China	25% (PHEV, BEV, FCEV) of new sales	2025
Japan	30%-40% Full Hybrids, and 20-30% of BEV/PHEV/FCEVs	2030
Korea	500K BEV / FCEVs	2022
Korea	33% of new sales BEV / FCEV	2030
France	500K PHEVs and 660K BEVs	2023
France	1.8m PHEVs and 3m BEVs	2028
France	100% BEVs / FCEV sales	2040
Germany	7-10m BEVs / FCEVs	2030
Germany	100% BEVs / FCEV sales	2050
Denmark	1m electrified vehicles / no sales of new diesel or petrol cars	2030
UK	50-70% EV	2030
UK	No new registrations of ICE	2035
Ireland / Iceland / Netherlands / Sweden / Israel	No new registrations of ICE	2030
Norway	No new registrations of ICE	2025
US	3.3m (PHEVs, BEV, FCEV) in 11 states	2025
US	100% BEVs / FCEV sales	2050
Canada	30% BEVs / FCEVs	2030
Canada	100% BEVs / FCEV sales	2040

Source: HSBC; Bloomberg; Reuters; IEA

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**The recovery in lithium prices
 has, in our view, been
 delayed by COVID-19**

Lithium: COVID-19 delayed recovery, but positive signs emerging

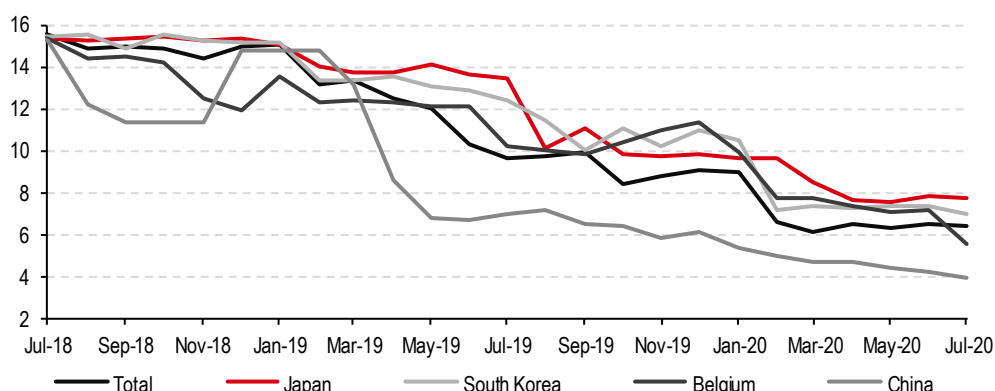
COVID-19 delayed a demand recovery, but long-term fundamentals remain positive

As COVID-19 impacted EV and overall car sales, the knock-on effects to lithium were no surprise as it became evident that the oversupplied situation that the market was just beginning to look past would instead be around for longer. And while we see positive data points – extended/increased EV subsidies and growth in China NEV sales – further waves of COVID-19 disruptions have kept uncertainty high and prices low. We maintain our long-term bullish outlook for lithium, driven primarily by growth in electric vehicles, but remain wary of near-term challenges.

Prices took a hit from COVID-19 but have not recovered...

Lithium prices globally took a hit as COVID-19 concerns began to percolate. Even in regions where prices had held at cUSD10/kg saw 20-30% price reductions, with no recovery in subsequent months. Prices in China, where the oversupply is largely concentrated, continued to slide lower and fell below an average USD4/kg in July, as some lithium producers have opted to prioritize volume over price in the region.

5.4. SQM lithium export average FOB USD/kg by region



Source: Chile National Customs Service, HSBC Research

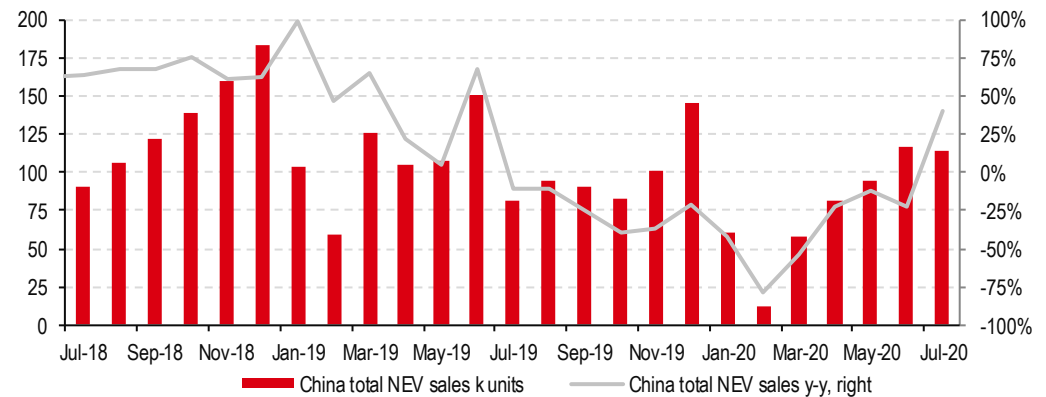
... even as supply is poised to get tighter...

The drop in auto production and sales globally, as a result of COVID-19, has pushed out demand recovery for lithium and extended the oversupply situation. Excess inventory, which was previously expected to be largely drawn down this year, is now likely to persist into 2021. Further disruption to demand would just propagate that inventory further. Still, the supply side remains fairly constrained – some producers have scaled back production and most have postponed or cancelled capacity expansions, while new ventures are facing challenges securing financing with the current low prices.

... and EV demand is poised to take off

On the demand side, the EV story continues to forge ahead. Several countries in the EU have announced additional subsidies with a clear focus on promoting BEV/PHEV vehicle demand, while the all-important Chinese market should benefit from its NEV subsidies extended by two years until 2022. Of note, Chinese NEV sales registered its first positive growth in July, albeit on easier comps, after being in the negative since the June 2019 subsidy cut.

5.5. China NEV sales post first y-y growth since June 2019

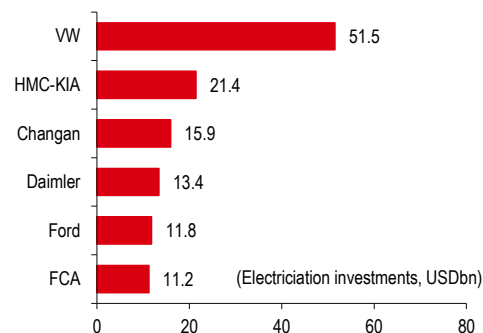


Source: BNEF, HSBC Research

VW Group is set to launch 70 new EV models over the next decade, up from 50 models previously

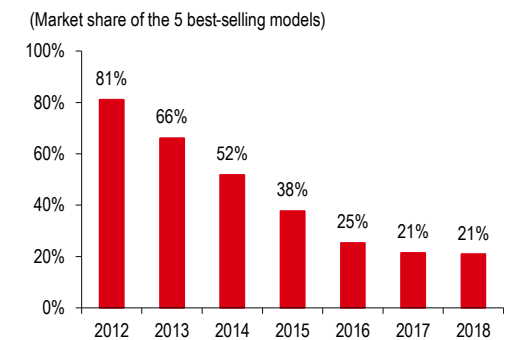
Furthermore, we continue to anticipate the number of EV models to continue to grow due to auto makers' increasing commitments to electrification. Last year, VW Group announced that under its revised electrification plan it would launch about 70 new EV models over the next decade, up from 50. This expansion plan increased its projection of EV volumes to be built on the Group's electric platform over the next decade from 15m to 22m. More EV models will expand the range of choice for consumers, which in turn should boost overall demand. In the past, the top five models had a market share over 50%, but this has fallen to nearly 20% over the last couple of years.

5.6. Electrification investments announced by automakers



Note: Investment figures as of 1H18.
Source: Bloomberg New Energy Finance (BNEF)

5.7. EV market is becoming more diversified, as share of the five best-selling models has declined



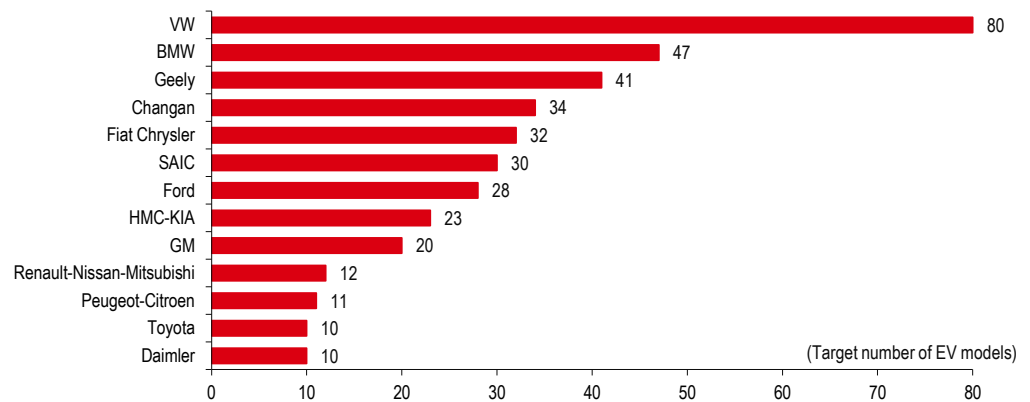
Source: Company data, EV-Volumes.com, HSBC estimates

High inventory and uncertainty are keeping lithium prices low in the near-term

The spectre of a second wave of COVID-19 and that pesky excess inventory

That still present excess inventory of lithium in the market, estimated at around a few months' worth, keeps things oversupplied. It would be further exacerbated if a second wave of COVID-19 were to force production suspensions and disrupt sales despite new subsidies. Assuming EV demand continues on pace and the market has worked through its excess inventory, it's possible we could be in a deficit in a few years. But that inventory and uncertainty are keeping prices low in the near term, despite the expected pickup in EV demand and constrained lithium production, making it challenging for producers trying to negotiate long-term contracts.

5.8. Number of EV models to be launched by 2025



Source: Company data, Bloomberg New Energy Finance (BNEF)

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Cobalt prices would have rebounded strongly in 2020 if it wasn't for COVID-19, in our view

Cobalt – Awaiting a demand recovery

Cobalt metal prices hit USD25,584/t low levels in July 2019, after reaching its multi-year highs of USD94,800/t in early 2018. The metal prices have somewhat recovered from the low witnessed in July 2019 and but have been broadly range-bound. There has been a rally in prices in the recent weeks from the trough, and LME cobalt prices have now reached the USD33,000/t level, back at pre-COVID-19 price levels. We believe the cobalt price surge was driven by supply disruption concerns in Africa amid restocking from Chinese refiners in anticipation of a rebound in demand.

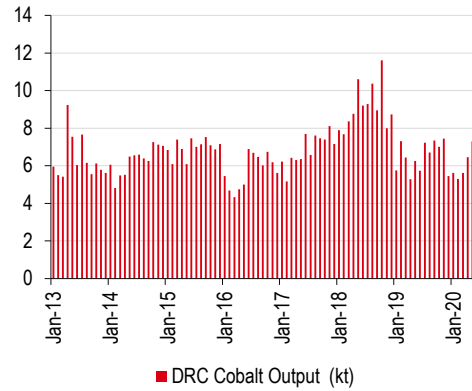
While the decline of NEV sales due to the global economic slowdown has made it difficult for the cobalt price to rebound, given prices are already at cost support levels, further downside to cobalt prices is unlikely. However, for the cobalt price to rebound would require signs of an economic recovery. We believe cobalt prices would have rebounded strongly in 2020 if it wasn't for COVID-19. The largest cobalt mine in the world, operated by Glencore, stopped production for two years in 2H19, which will tighten the market and help with destocking. However, demand has now collapsed due to COVID-19, so we believe the rebound in cobalt prices driven by tighter supply will now be pushed back by a year.

According to the data released by the Democratic Republic of Congo's Central Bank, the country's cobalt production dropped c29% in 2019. Despite the drop in production and reduced supply, the limited rally in the metal price suggests the sector still has excess cobalt inventory to destock, and that EV penetration rates will need to continue increasing before we see a major shift in the demand-supply balance. We believe the reduction in mine supply could lead to a tighter market in 2021.

We expect demand for cobalt to rebound strongly in 2021, mainly driven by increasing battery production as a result of pent-up demand from new energy vehicle (NEV) sales and increasing demand for energy storage systems (ESS). We are forecasting cobalt demand to grow at a CAGR of 5% from 2019 to 2023, and batteries as a percentage of cobalt demand will increase from 55% in 2019 to 60% in 2023.

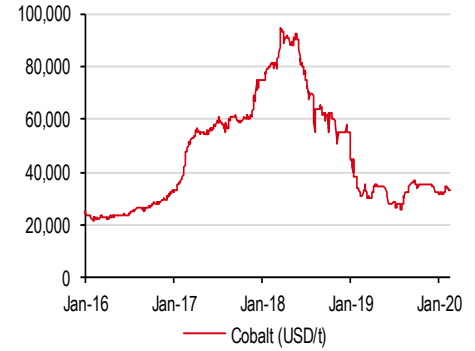
Besides NEV and ESS demand, we expect portable electronics demand will continue to grow steadily post the virus as battery production keep increasing and cobalt is increasingly used in more products. Cobalt demand from the battery industry is more volatile compared to other battery materials as the amount of cobalt required changes amid technology developments. However, we believe the potential to reduce cobalt usage in future battery production is exaggerated, and we expect batteries with cobalt will continue to be the mainstream going forward.

5.9. DRC cobalt output is up 6% y-o-y during 1H20; though from the depressed level of 2019



Source: Banque Centrale DRC, Refinitiv DataStream, HSBC

5.10. LME Cobalt price range-bound



Source: Refinitiv DataStream, HSBC

6. Agriculture: Many shocks, but prices generally steady

- ◆ COVID-19, the US-China trade tensions, African swine fever (ASF) and changing climates have influenced agricultural markets recently
- ◆ Despite fears of widespread supply chain disruption from COVID-19, so far, any disturbances have been fairly localised
- ◆ The effects of African swine fever and Phase One of the US-China trade deal have continued to alter agricultural trade flows

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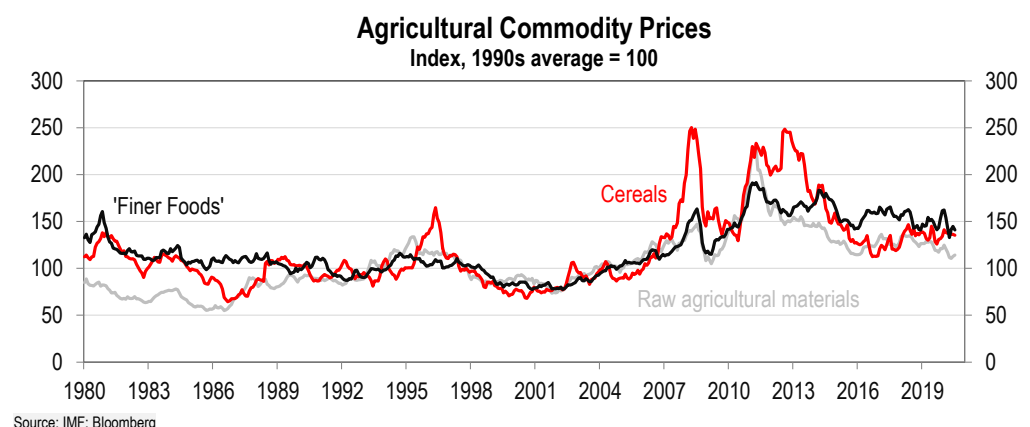
Shifts and shocks

Agricultural product markets have continued to face significant shocks, including COVID-19, US-China trade tensions, and the impact of Phase 1 of the US-China trade deal and the impact of African swine fever.

However, despite concerns that COVID-19 could have widespread disruptive effects on agricultural markets, so far, the impacts have been quite localised. As we describe below, US meat markets were disrupted by COVID-19 impacting on abattoir operations, which saw a sharp spike in beef prices in May 2020, followed by a retracement. Still in the US, lumber prices have risen strongly over recent months, driven by a sharp rise in demand for use in household Do-It-Yourself projects. In India, supply disruptions have lifted vegetable, egg, fish and pulse prices.

However, the overall impact of these shocks on aggregate agricultural commodity prices has been fairly limited – certainly when compared with the big moves in some agricultural prices (particularly of cereals) during the 2008/09 Global Financial Crisis (Chart 6.1).

6.1. Agricultural prices have been steadier through the COVID-19 crisis than the GFC



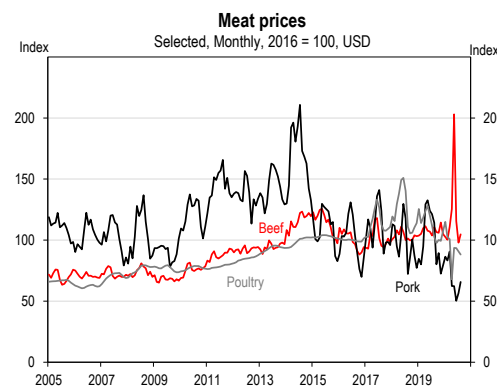
This seems to partly reflect that inventory levels in most grain markets are fairly high. Also, unlike the Global Financial Crisis, the COVID-19 crisis has not had a significantly disruptive effect on trade finance.

Some clear but localised COVID-19 shocks

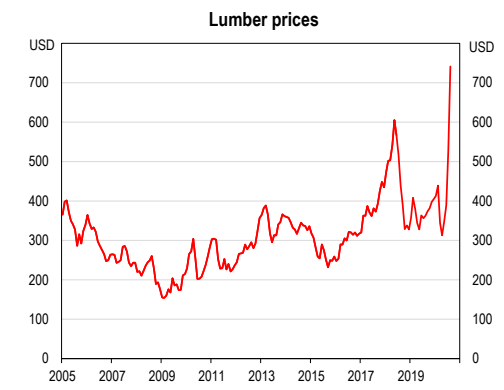
Some localised shocks, but overall agricultural prices generally fairly stable

US beef prices rose sharply in May as COVID-19 disrupted US abattoir operations, but fell back to pre-COVID-19 levels as meat processing operations returned to normal rates. US lumber prices have increased strongly in July and August as a result of demand for Do-It-Yourself home renovation activity (perhaps a result of more Work from Home, furloughed worker schemes and high unemployment), and limited anticipation of this boost to demand by sawmills

6.2. COVID-19 temporarily disrupted many US abattoir operations



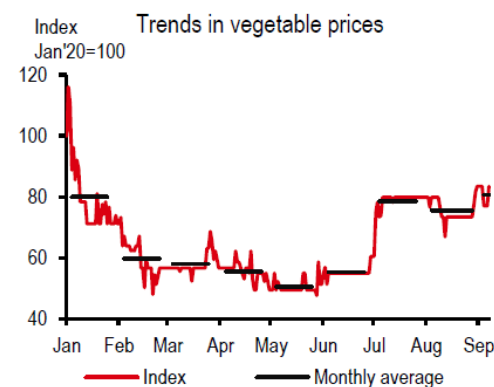
6.3. Lumber prices have skyrocketed on US demand for Do-It-Yourself projects



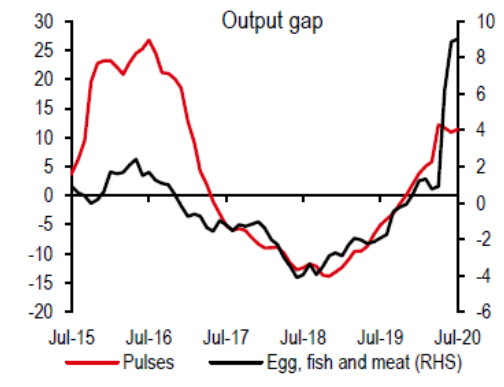
Vegetable and protein supplies have been disrupted in India

In India, the prices of vegetables and some proteins have risen as supply has been disrupted, which is a risk to the outlook for inflation, which has already started to pick up (Charts 6.4 and 6.5). For more on this see [India COVID-19 chartbook: Slower recovery amid second wave concerns](#), 9 September 2020.

6.4. COVID-19 has seen disruptions ...



6.5. ... in India's food supply chain



Phase 1 of the US-China trade and African swine fever

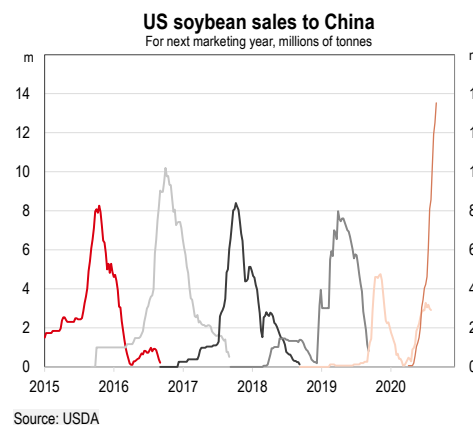
Aside from COVID-19, another big global driver of recent changes in across agricultural commodity markets has been further moves in response to Phase 1 of the US-China trade deal, which was signed in January 2020. Trade in agricultural products had been heavily affected by rising trade tensions between the US and China through 2018 and 2019. At the time, China imposed significant retaliatory tariffs on US goods exports, which saw a sharp shift in China's imports of soft commodities away from US suppliers (as we discussed in detail in our previous Global Commodities update, see [Global Commodities: COVID-19 and climate change](#), 4 March 2020).

Phase 1 of the US-China trade deal and the impact of African swine fever are affecting global meat and grain trade

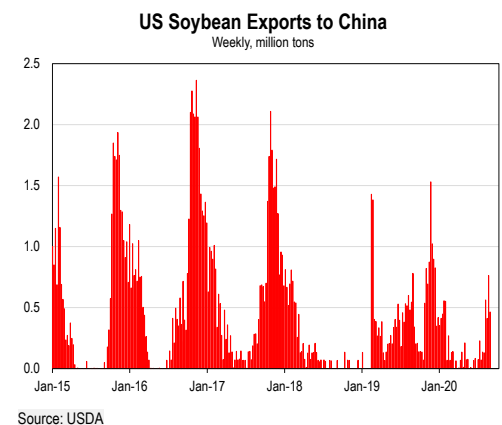
However, the signing of Phase 1 of the US-China trade deal in January 2020 included a commitment from China to significantly boost its imports of US products, particularly soybeans and pork. China committed to purchase an additional USD12.5 billion worth of US agricultural products in the first year of the agreement and a further USD19.5 billion worth in the second year.

US soybean sales (for the coming year) to China have risen sharply in recent months to be well above seasonal peaks reached in previous years (Chart 6.6). These sales have yet to come through as exports but should be expected to lift export volumes over the coming quarters (Chart 6.7). The combination of these strong sales and some weather-related concerns about US soybean supply have recently lifted US soybean futures prices to their highest levels since 2018.

6.6. US soybean forward sales to China are up sharply ...



6.7. ... although these are yet to come through the export numbers



The Phase 1 agreement has also come at a time when China has been boosting its protein imports to replace lost pork as a result of African swine fever. Although there has been some pick-up in mainland China's sow herd size since its trough in late 2019, the herd size is still only 82% of its pre-African swine fever level. Mainland China, which is usually self-sufficient in pork supply, has ramped up its meat imports and particularly its pork imports from the US. For more details see the meat section below.

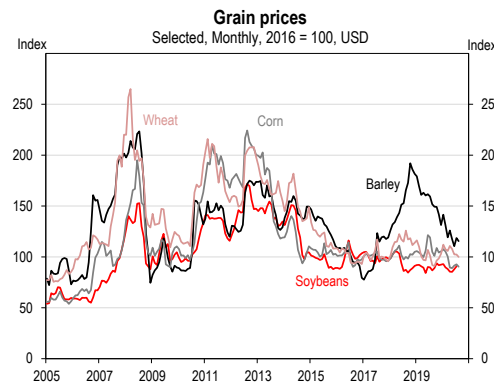
Grains: Prices generally steady on ample supply

Despite all of these shocks, most grain spot prices have generally remained steady (Chart 6.8). A part of the reason has been generally strong production of most grains (Chart 6.9).

Grains prices have generally remained steady as markets remain amply supplied

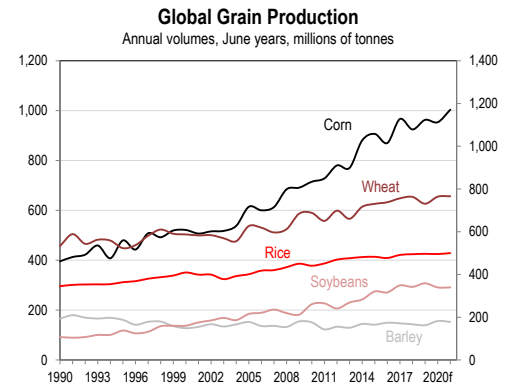
Many of the concerns that poor weather could weigh on production have abated over the past six months. For example, after an extended period of drought, Australia has had an increase in rainfall which is set to support a boost to crop production. The Australian government forecaster, ABARES, is expecting Australia's winter crop, including wheat, canola, barley and other grains, to be the largest in four years.

6.8. Grain prices have not been significantly impact by COVID-19 ...



Source: IMF

6.9. ... as production has remained fairly strong

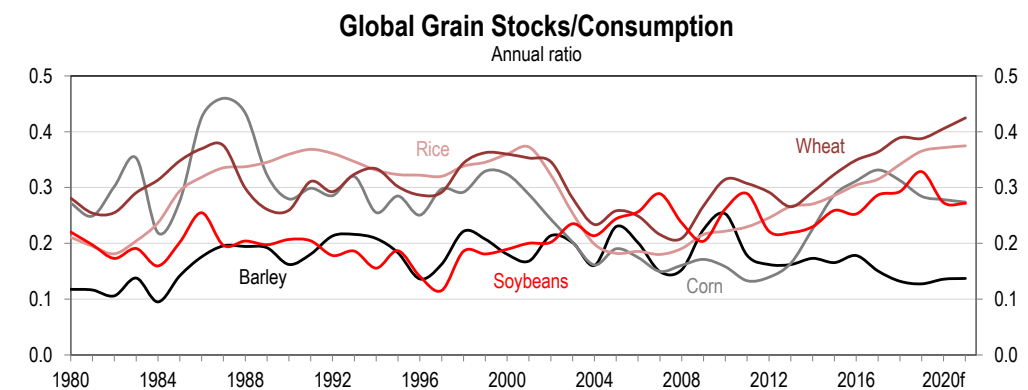


Source: USDA

Grain markets have been far less volatile during COVID-19 than during the 2008/09 Global Financial Crisis shock

Conditions in global grain markets are quite different to how they were just prior to the 2008/09 Global Financial Crisis, which was an episode that saw significant grain price volatility (Chart 6.10). In the lead-up to the GFC, stocks of most grains were lower and there had been a rapid acceleration in demand, particularly from China.

6.10. Prior to the COVID-19 crisis grain stocks have generally been quite high



Source: USDA

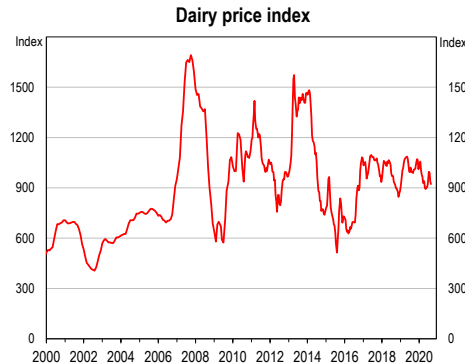
Dairy: Market tight, which is supporting prices

Dairy prices have been broadly steady

COVID-19 appears to have only had a limited impact on the global dairy market. Although dairy prices fell in response to the COVID-19 shock, the decline was comparably modest and prices have since risen (Chart 6.11). Like many other agricultural commodities the swing in dairy prices has been far less severe than occurred during the 2008/09 Global Financial Crisis. The price moves have also been far less aggressive than occurred in 2014-15, when mainland China undertook significant de-stocking of dairy product.

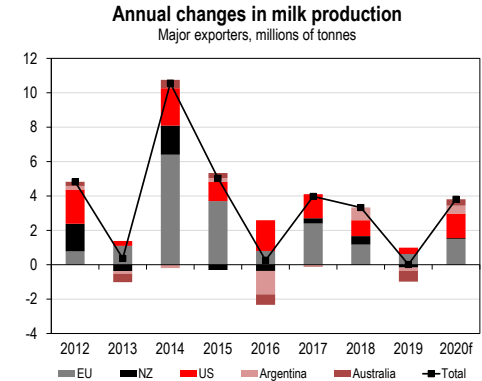
Demand from mainland China has generally held up well, and is expected to be supported by the recovery that is underway in that economy. Much like other proteins (discussed below in the meat section), the COVID-19 shock has seen a large substitution from consumption outside the home, to in-home consumption. While the outlook for demand is positive, USDA production estimates for 2020 have been revised higher reflecting good growing conditions, boosting supply, which is a risk to the price outlook (Chart 6.12).

6.11. Dairy prices have remained comparatively stable, compared with previous shocks



Source: Global Dairy Trade

6.12. Supply is forecast to rise solidly



Source: USDA

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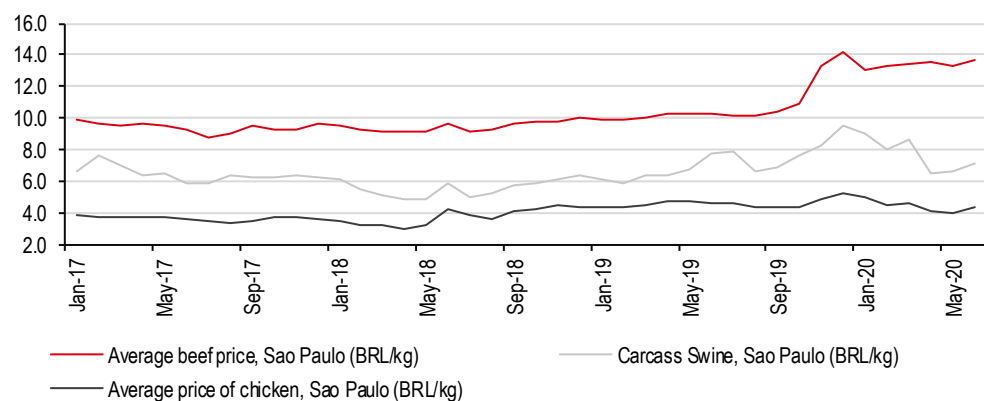
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Meat: Tightening supply into strong demand

Despite the disruptions caused by the COVID-19 pandemic and African swine fever, protein consumption has remained resilient. Social distancing policies, to deal with the COVID-19 crisis, have generally shifted consumption from on-premises and food service to retail.

Unemployment, inflation and uncertainty may prompt consumers to save on their groceries. However, we have not seen this yet. Perhaps this is because consumers are spending less on discretionary items. Nonetheless, we may see down trading ahead as the price differential between the three proteins can be significant (Chart 6.13).

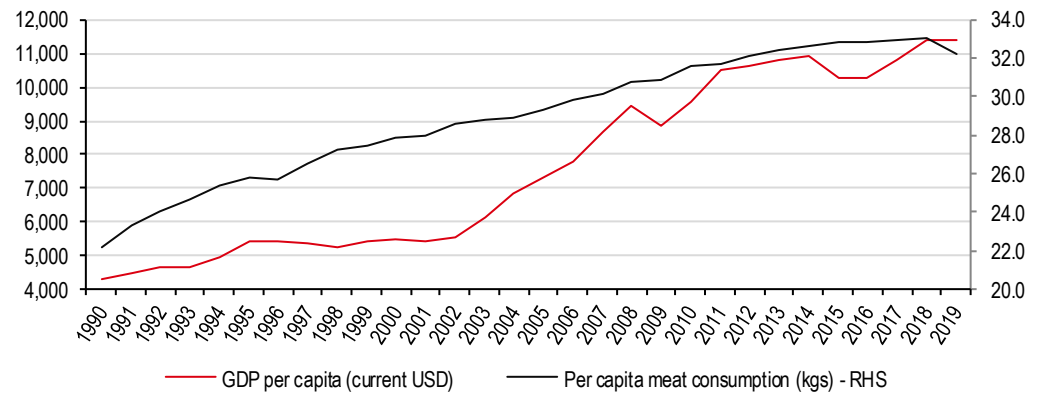
6.13. Chicken is the cheapest protein while beef is the most expensive



Source: Refinitiv Datastream

From a supply perspective, we expect COVID-19 related disruptions to diminish but we think African swine fever will continue to prompt a reliance on the global protein export market. Simply put, the world needs safe protein from bio-secure sources and without easy, scalable or cheap replacements to poultry, pork and beef, the industry looks attractive to us (Chart 6.14).

6.14. Historically, meat consumption has been positively correlated to rising incomes

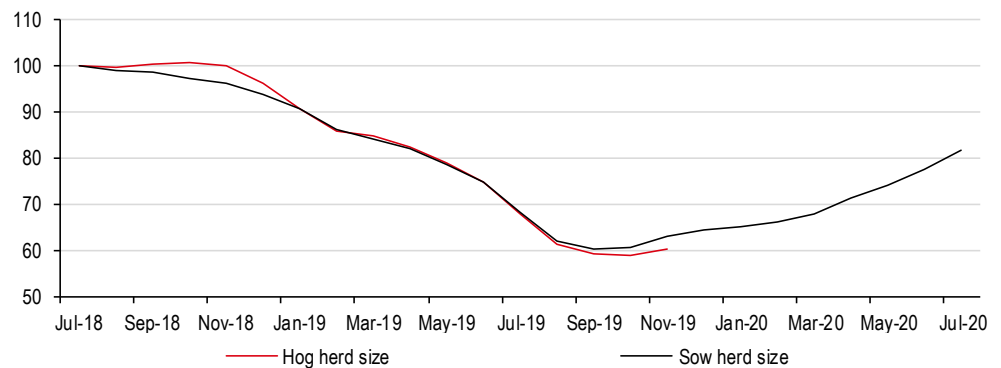


Source: World Bank, OECD

China's hog herds are rebuilding but still remain below pre-African swine fever levels

Global pork: African swine fever remains a key catalyst affecting global protein dynamics. The USDA expects global pork production to fall c6% this year on account of a 15% production slump in China. Despite slowly recovering sow and hog herds in China – now at c82% and 77% of pre-African swine fever levels, respectively – pork production in 1H20 was c23% below that of last year (Chart 6.15). This is significant. It represents a c9mmt deficit and is equivalent to c28% of global protein exports in 2019.

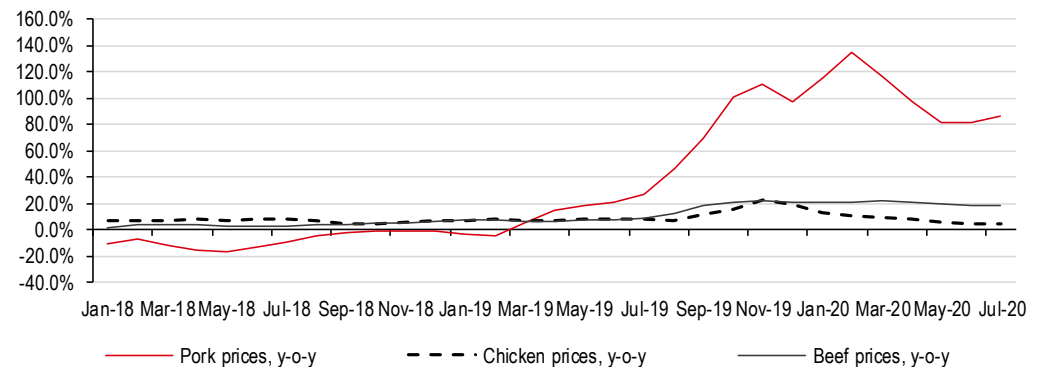
6.15. The hog and sow herds in China stand at c77% and c82% of pre-ASF levels



Source: CEIC. Data for hog herd growth from Dec 2019 to June 2020 is unavailable

Pork shortages have yielded a c102% y-o-y YTD increase in average pork prices in China and hence the pricing of substitutes such as beef and poultry have also increased – up c20% and c8% YTD on average, respectively (Chart 6.16).

6.16. Pork prices remain high in China on tight pork supply

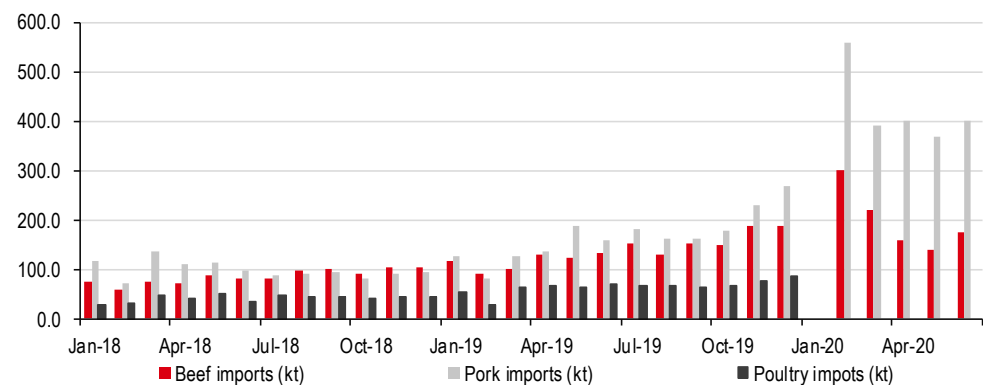


Source: CEIC

China has increased its meat imports substantially

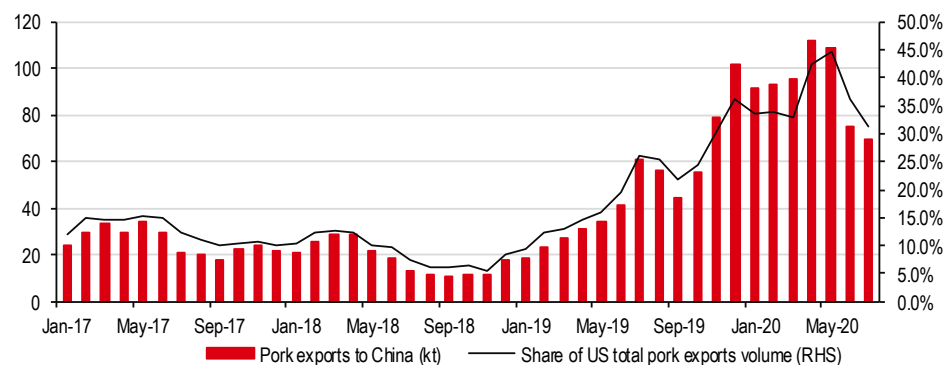
China, which has historically been self-sufficient in pork and poultry, continues to increasingly rely on imports in order to meet the protein supply shortfall (Charts 6.17-6.20). Beef and pork imports are up 72% and 206% YTD y-o-y despite a high base.

6.17. China protein imports have continued to increase



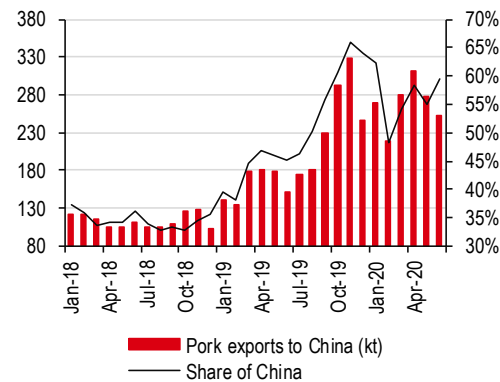
Source: CEIC. *Data for poultry imports unavailable from Jan 2020. Data for beef and pork imports unavailable for Jan 2020

6.18. US pork exports to China are high – despite a strong USD, they are up c172% YTD y-o-y



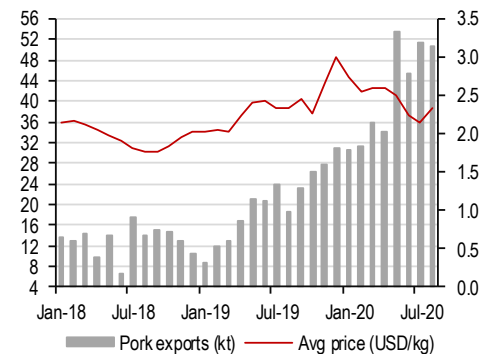
Source: USMEF

6.19. Pork exports from the EU to China are up 67% YTD y-o-y



Source: Eurostat

6.20. Pork exports from Brazil to China are up c148% YTD y-o-y

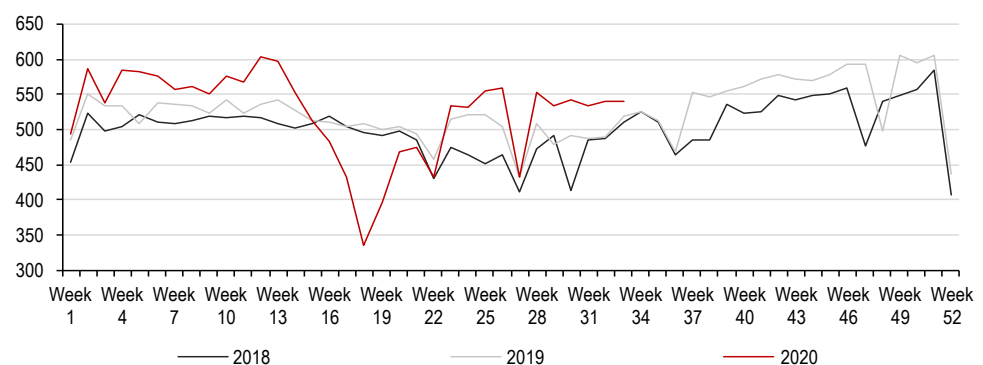


Source: Comexstat

COVID-19 temporarily disrupted supply of pork ...

Beyond African swine fever, COVID-19 has temporarily disrupted the pork supply chain in key markets as the processing of pork is often manual. The graph below illustrates a steep decline in US pork production in April and May (Chart 6.21). However, operational adjustments have been made by the industry and pork production in the US is now up 2.6% YTD y-o-y. In Brazil and in the EU, production also seems to be recovering.

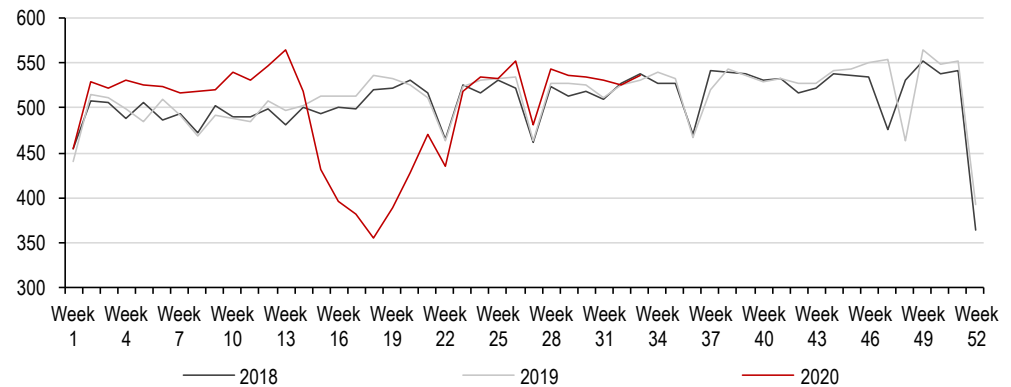
6.21. Weekly pork production in the US is now up 2.6% YTD y-o-y (m lbs)



Source: USDA

Global beef: The USDA expects global beef production to decline 1.5% y-o-y in 2020 due to production declines in Australia, the US and Brazil, which together make up c40% of global beef production (Chart 6.22). Australia has been facing tough weather conditions and the US and Brazil have been adjusting to COVID-related disruptions.

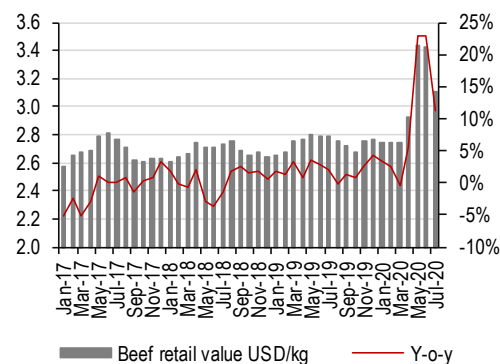
6.22. After a major slump in May, weekly beef production in the US is almost back to pre-COVID-19 levels and is down only 1.7% YTD y-o-y (m lbs)



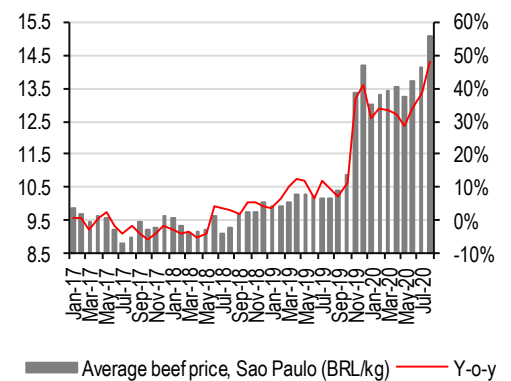
... and of beef

As protein supply was affected and the global market increasingly relied on beef imports, beef prices have increased to record highs (Chart 6.23). In the US and Brazil, even as beef production has now almost normalized, retail prices have been sticky and remain particularly high (Chart 6.24).

6.23. Domestic beef prices are at record highs in the US...

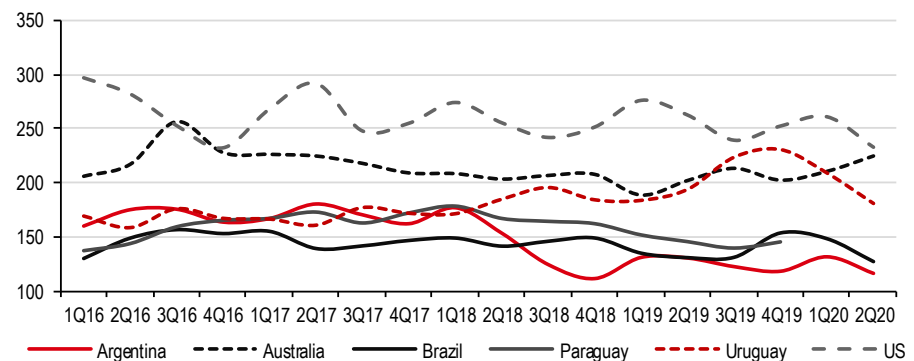


6.24. ...and in Brazil



From a margin perspective, strong pricing and the backlog of cattle may bode well for meatpackers this year and into 2021, especially as the US and Brazil are facing a positive cattle cycle (Chart 6.25).

6.25. Global cattle prices have been declining due to limited processing capacity

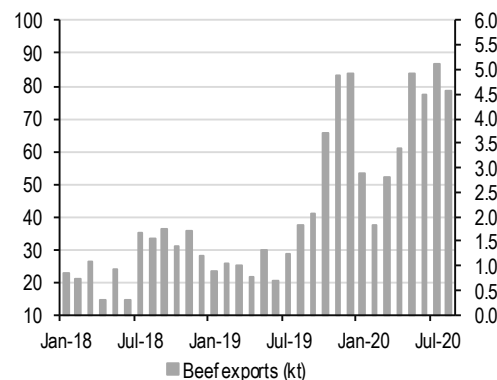


Source: MLA

Brazil's exports of beef to China have more than doubled this year

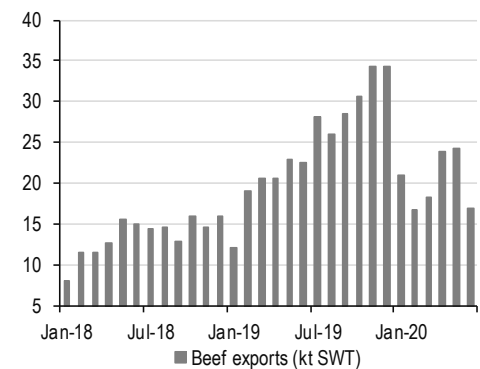
Protein shortages in China have accelerated its reliance on the global protein market. Beef exports from Brazil – the world's largest beef exporter – to China have more than doubled this year. Beef exports from Australia to China have declined on the back of lower production and a partial import ban by China (Chart 6.27).

6.26. Beef exports from Brazil to China are up c150% YTD y-o-y



Source: Comexstat

6.27. Beef exports from Australia to China



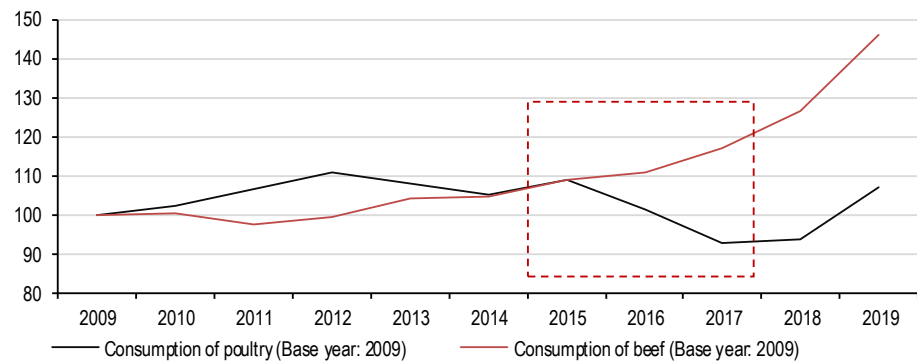
Source: MLA

The length of China's African swine fever exposure could support a long-term shift in protein consumption towards alternatives to pork. In fact, China's consumers have shown a growing preference for beef over poultry. Indeed, China's beef consumption has grown at a 10-year CAGR (2009-2019) of c4%, while poultry consumption has been c1% (Chart 6.28).

Chicken has been a primary substitute for pork in China

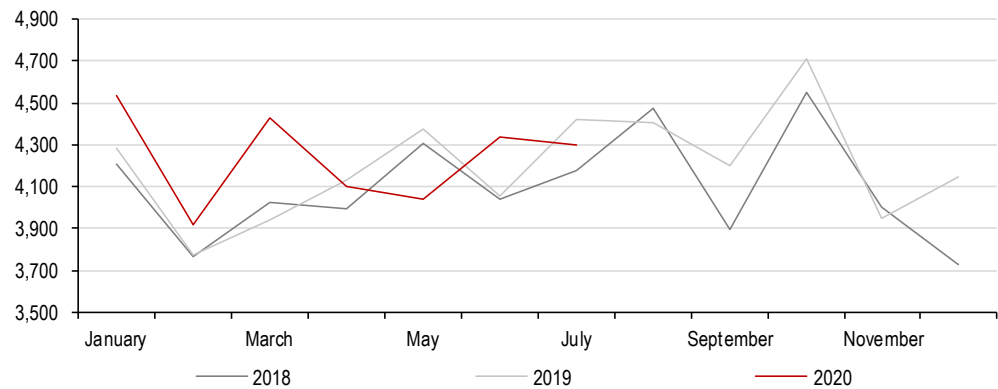
Global poultry: The USDA expects poultry production to increase 1% y-o-y in 2020 primarily from higher production in China and the US. Chicken has been the primary substitute for pork for consumers in China as it is a cheap alternative and its cycle and production are much simpler vis a vis beef (Chart 6.28). According to the USDA, the Chinese government is promoting the consumption of chicken in order to prompt a shift in consumers out of pork, to accelerate the recovery of pork production amid high pork prices in China. In the US and in Brazil, poultry production has not been materially impacted from COVID-19 disruptions as the production is much more automated compared to that of beef and pork. In the US, poultry production is up 2.3% YTD y-o-y (Chart 6.29).

6.28. China's chicken consumption declined after the outbreak of avian influenza in 2015



Source: USDA

6.29. US chicken production was not significantly impacted by COVID-19 and is up 2.3% YTD y-o-y (m lbs)



Source: USDA

Global poultry consumption is expected to grow c1% y-o-y in 2020, per the USDA, primarily on higher demand in China as domestic pork supply remains tight.

All in all, in a backdrop of tight global protein supply and resilient demand, we expect protein prices to remain strong this year.

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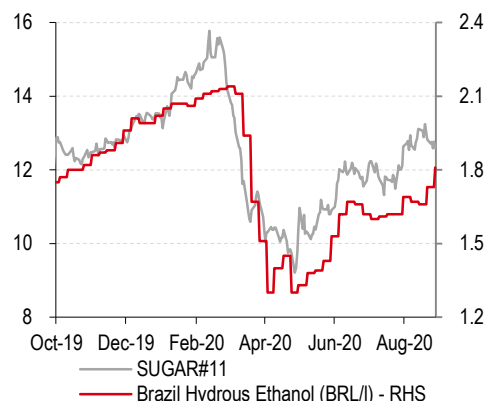
Sugar: Recovery could stall as production surplus balloons

Sugar prices have bounced back since falling sharply in April (+31% since April lows) thanks to a recovery in the oil and ethanol markets (Chart 6.30). The recovery was better than our estimates, mainly due to moves in the Brazilian Real and a sharp recovery in oil prices. However, the fundamentals have not improved much, with sugar continuing to trade at a hefty c33% premium in August over Brazilian ethanol (Chart 6.31), and are expected to remain so, as we explain below, leading to Brazilian mills maximizing sugar output.

Brazil's government agency CONAB predicts a record c39mt of sugar output in 2020-21 (April to March), a 32% or 10mt increase over last year, more than enough to offset the global deficit forecast prior to the outbreak. The likely demand destruction due to lockdown and India's production rebound will further add to the surplus. Hence we see a large surplus of sugar in 2020 and 2021, capping material price increases (unless oil prices change dramatically). See our note: [Sugar: Long road to recovery](#), published on 27 May 2020.

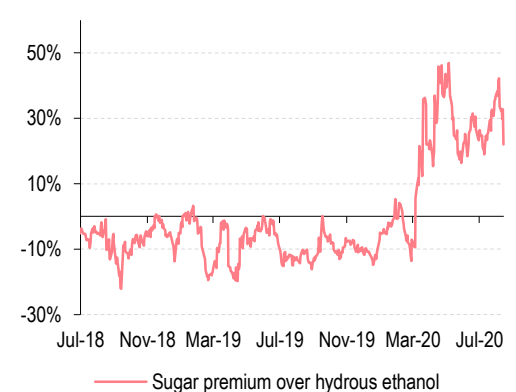
We acknowledge that the potential harvest delays in India due to migrant labour shortage as a result of rising COVID-19 cases could spike up the prices in the coming months, but this effect is expected to be short-lived.

6.30. Sugar and ethanol prices have continued to recover



Source: HSBC, Bloomberg

6.31. High sugar premium has already maximized Brazilian sugar output



Source: HSBC, Bloomberg

COVID-19 has hit sugar demand and supply hard

COVID-19 has upended global sugar supply-demand balance

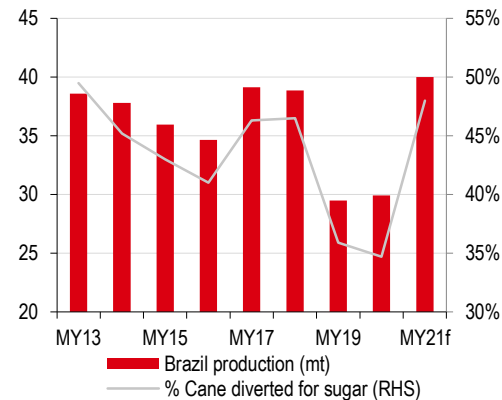
COVID-19 has caused collateral damage to the global sugar industry, affecting both the supply and demand side of the equation. Brazil, the usual swing player in times of surplus, would be forced to maximize sugar output due to lacklustre ethanol prices, resulting in an additional 10mt of sugar output (c12mt at max capacity of 50% sugar 50% ethanol) as per CONAB.

India, the second largest producer after Brazil, is expected by CONAB to have a rebound in output of 13-16% in 2020/2021, on the back of good monsoon conditions. This could lead to a record 6-7mt of exports from India. Thailand, the second largest exporter, is reeling under drought for two consecutive years, but the production shortfall in Thailand could be more than offset by production increase in India and Brazil. Moreover, Thailand has received rainfall in 2Q20 that has improved the production outlook marginally in the past two months.

On the other hand, we expect 3-5mt of demand destruction in 2020 due to industrial shutdowns, given that c60-70% of demand is industrial. Hence we believe 2020 and 2021 will be surplus years for sugar which constrains a price recovery. While India's cane planting has not been affected much by COVID-19, there could be potential delays in harvest. The harvest season

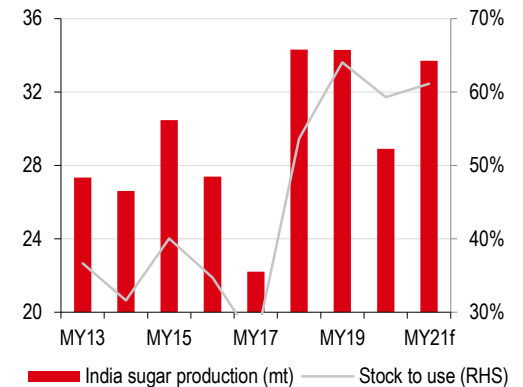
usually starts in October, however the strong surge in COVID-19 cases could hinder availability of migrant labour and slower crushing rates in India. However, the delay could just be a temporary phenomenon, hence unlikely to cause sustainable increase in prices.

6.32. Brazil to reclaim its position as world's largest sugar producer



Source: USDA (MY = Marketing Year)

6.33. India's massive stock to use at over 60% caps global price increases



Source: USDA

Sugar is expected to continue to trade at a premium over ethanol

Sugar is expected to continue to trade at a premium over ethanol

We believe ethanol will continue to face a supply glut as production is likely to surpass demand. Assuming a c10% decline in 2020 'Gasoline C' consumption in Brazil, ethanol demand would decline by 20-25% to 25-27bn litres at 50% hydrous blending rate. On the other hand, production is expected to fall by just 15-20% to c27-29bn, pointing to a surplus in 2020. Given the surplus and BRL depreciation, sugar will continue to trade at a premium over ethanol despite factoring in potential seasonal increase in ethanol prices in 4Q20 and 1Q21.

To put this into perspective, ethanol parity vs gasoline usually increases in 4Q and 1Q of every calendar year due to seasonality. Assuming the last 7-year average of c68% ethanol parity in 4Q20 (current parity at 64%), spot crude oil and BRL rates imply a 12% premium over current sugar prices. Even if oil prices were to increase to USD55/bb (less likely scenario), our theoretical model suggest that the oil implied ethanol price would still trade at 4% premium over current sugar prices (Table 6.34).

6.34. Theoretical oil implied ethanol price vs sugar

Scenario	I	II
Brent crude oil price (USD/bb)	44	55
USD:BRL	5.3	5.3
Parity: Ethanol- Gasoline C	68%	68%
RBOB per 15 yr regression analysis (Usc/g)	1.3	1.6
Implied Brazil gasoline pump price (BRL/L)	4.0	4.3
Ethanol pump price (BRL/L) - implied	2.7	2.9
Ethanol ex-mill MS (BRL/L) - implied	2.0	2.2
Ethanol ex-mill MS (BRL/L) - Usc/lb - implied	10.8	11.6
Spot sugar price (Usc/lb)	12.1	12.1
Sugar premium/(discount)	12%	4%

Source: HSBC estimates, Bloomberg

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Fertilizers: Strong demand brightens urea and phosphate outlook

2020 has been a good year for fertilizer demand due to acreage expansion and good weather conditions across key markets, including the US, India, China and Latin America. COVID-19 does not seem to have impacted agricultural use of fertilizers (urea and phosphates in particular) highlighting that agricultural demand is more linked to underlying dynamics – weather, acreage and farm economics in the short term. Strong demand has drawn down inventories and lifted urea and phosphate prices higher, however ammonia and urea ammonia nitrate (UAN) have been affected by weak industrial demand, leading to a mixed recovery.

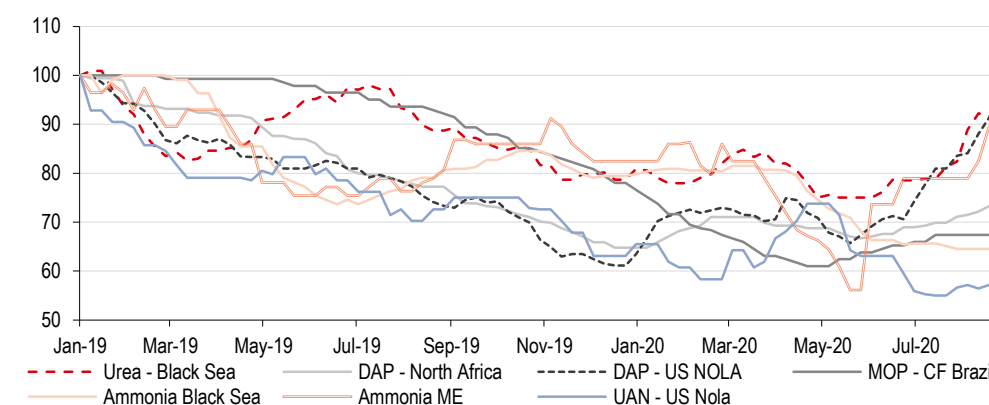
With regards to the outlook, urea's supply and demand dynamics are more favourable than other fertilizers, as we have highlighted in previous reports. After the recent surge, we believe that urea prices will remain at elevated levels through 2020, due to potential record import demand from India. The outlook for phosphate prices is also brightening as strong demand has drawn down inventories while concerns about the impact of new supply appear to be largely unfounded. Potash prices have stabilized following settlement of Chinese contract prices.

Mixed recovery with urea and DAP outperforming while ammonia and UAN remains weak

Prices of Black Sea urea and di-ammonium phosphate (DAP) from North Africa have increased by 22% and 11% since June beginning (Chart 6.35). India's import tender was the primary driver for urea, hence US urea prices did not move as much as Black sea and Middle East, however they are expected to follow suit as more clarity emerges on India's import demand.

The prices of DAP from the US have, however, risen by c30% on Mosaic's petition seeking countervailing duties on phosphate imports from Morocco and Russia.

6.35. Nitrogen phosphorus potassium (NPK) price performance



Source: HSBC, CRU

Urea prices to remain elevated thanks to standout India demand

The recent strong surge in urea prices (+25-30% across regions since June) is mainly attributed to the expectation of strong import pipeline from India. A solid c9% increase in acreage and good soil moisture in India have aided strong growth in fertilizer application and import demand, particularly for urea. India's urea import demand for 2020 could reach a record 9-10mt as per industry estimates. Of the total imports, approx. 50-55% of imports are expected in the last four months of 2020 for which the Metals and Minerals Trading Corporation of India (MMTC) has already started issuing tenders.

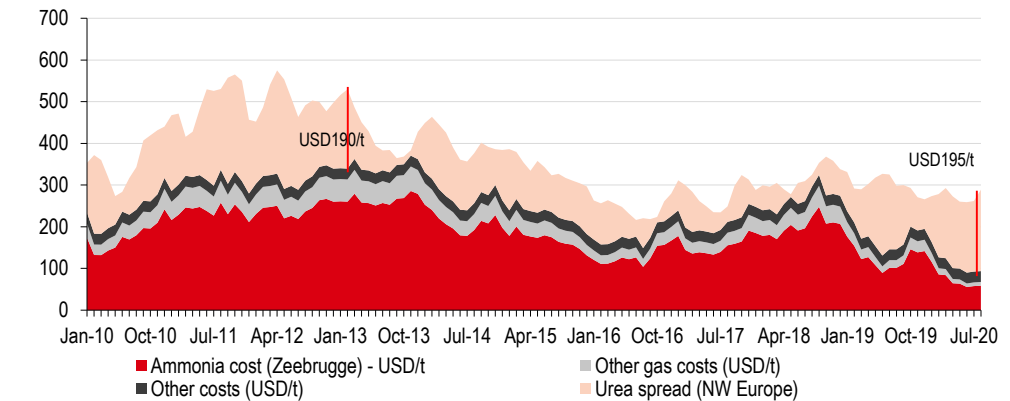
On the supply side, the commissioning of two major new production plants of c1.3mt each (one in India and other in Iran) has been delayed which has further tightened the balance. Hence, despite our expectation of a surge in Chinese exports during 2H20, we believe India's surge in imports in

Urea prices are expected to remain elevated

very compressed time frame and delayed new capacity addition are expected to support urea prices to stay at elevated levels during the coming months, contributing to healthy margins.

A key upside risk to prices is the rising geopolitical tensions between India and China that limits Chinese participation in India's tenders. However, our base case assumes Chinese participation, as was the case in latest tender in August.

6.36. Urea spread at healthy levels on stable prices and lower gas costs

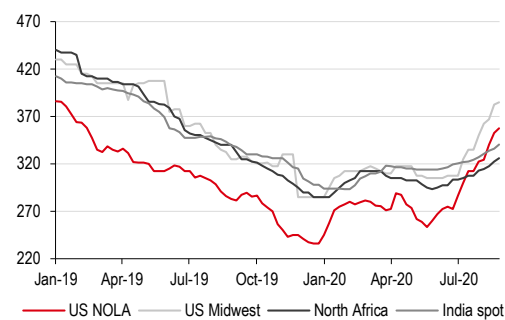


Phosphate outlook has brightened and is set for gradual recovery

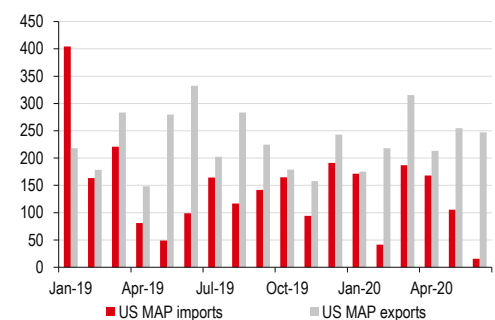
Phosphate prices are set for gradual recovery from 2H20 as strong demand bounces back (after an abysmal 2020) which, along with supply rationalisation, has reduced excessive inventories (Chart 6.37). At the beginning of 2020, phosphate prices were trending down due to initial fears about demand destruction on account of COVID-19. In contrast, demand turned out to be stronger across regions and there is good amount of visibility on import demand from India and Brazil.

The outlook for phosphate prices has improved

6.37. DAP prices: US premium expanded



6.38. US MAP imports declined significantly in June 2020



Furthermore, the US premium has expanded as imports into the region are beginning to decline following Mosaic's petition with the US government seeking countervailing duties on phosphate imports from Morocco and Russia. Mosaic's petition has improved sentiment in the US and could likely limit undercutting of prices by OCP in Morocco in the short term. Our expectation of phosphate price recovery is not withstanding the US's decision on Mosaic's petition.

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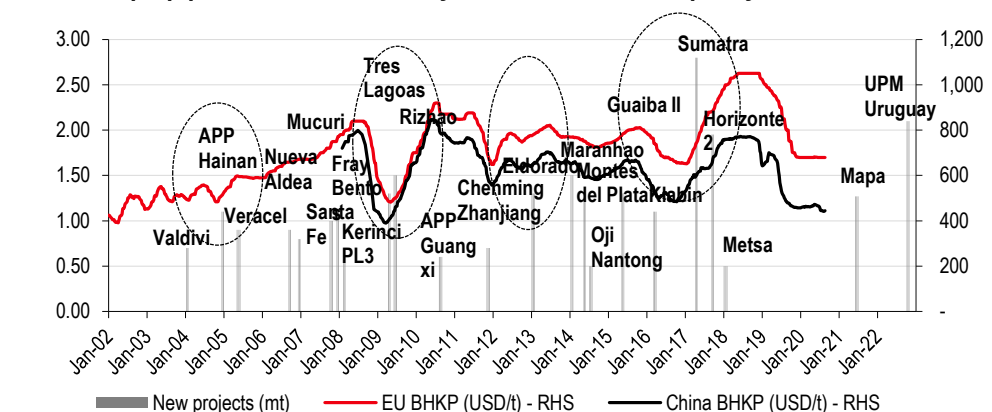
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Pulp & Paper: Improving but still lower for longer

After experiencing a significant decline through most of 2019, pulp prices have stabilized for the past several months around the previous trough levels reached in 2017 (Chart 6.39). The decline in prices has been driven by falling demand, de-stocking efforts by paper producers of both finished product and pulp, and increased supply.

The outbreak of COVID-19 hampered the recovery as it impeded the reduction of high inventory levels, which kept prices close to trough levels. The COVID-19 outbreak has been impacting paper production, especially printing and writing (P&W) paper, and thus demand for market pulp. During 1H20, the higher production of tissue papers – given hygiene requirements – somewhat offset the decline in graphic paper production. The strong tissue demand seems to be fading (back to normalized growth rates), while graphic paper production has only shown moderate signs of a pick-up.

6.39. BHK pulp prices have historically fallen before new capacity comes on



Source: RISI, FOEX, Company report, HSBC

COVID-19 has not led to any significant disruptions to pulp production

On the supply side, market pulp producers have not faced any significant disruptions due to the outbreak, and most annual maintenance downtimes scheduled for 1H20 were postponed. On the positive side, these downtimes are now expected to materialize in 2H20, which is likely to tighten the market.

Going forward, we expect bleached hardwood kraft (BHK) prices to start increasing in the coming months, but to remain at 'lower for longer' levels as the improvement in tissue demand fades while demand from graphic paper has yet to pick up materially.

While hardwood shipments were strong in 1H20 and helped in reducing inventories, we note that shipments do not necessarily reflect demand. The pulp and paper products council (PPPC) expects shipments to weaken in 2H20 as a result of a higher base in 4Q19, moderation in restocking activity and lower demand. Inventories at ports and pulp producers have come down, thanks to efforts from pulp producers at selling bulk volumes at fixed prices.

According to revised data released by PPPC, producers' BHK inventory level at 43 days as at the end of July were much closer to historical average and have receded from the high levels witnessed at the start of year. There will be lower supply in 2H as most of pulp producers will take maintenance downtimes (including the ones deferred in 1H), and pulp prices should move higher from current spot levels, especially as 12-15% of the cost curve is loss making. However we don't necessarily expect a significant increase in pulp prices without material improvement in demand.

Hardwood producer inventories are back to normal levels

We do expect some further recovery in BHK prices in 2021 as demand recovers. Historically, BHK prices have come under pressure whenever there are significant capacity additions (as Chart 6.39 shows).

Suzano has ramped up production which it had temporarily reduced last year. Arauco's MAPA project will add c1.3mtpa of new BEK capacity in June 2021. UPM announced its plan to build a 2.1mtpa BEK pulp mill in Uruguay, which is expected to start in 2H 2022. Both these projects add to c3.4mtpa of incremental supply during 2H21-2022. Given this increase in incremental supply, we think BHK prices are unlikely to return to the highs (USD775/t) of the last several years.

Notes

Disclosure appendix

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